

THE INDONESIAN QUARTERLY

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- RI - Australia Ties: What Went Wrong?
- Indonesia and the Future of ASEAN
- ASEAN's Relevance: Has It Become Questionable?

REVIEW OF POLITICAL DEVELOPMENT

- Bringing the Power Back to the People: Reflections on the People's Consultative Assembly (1999-2004)
- Post Election Politics and Indonesia's New Regime of Reformation

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- Governance in East Asia: The Case of Hong Kong -- Interactions Between Economic Development and Democracy
- Poverty Alleviation in Indonesia Since the Economic Crisis: Beyond Immediate Relief



The Quarterly

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The Logo



To better represent the underlying ideas that gave birth to the CSIS in 1971 the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, designed by G. Sidharta, it consists of a disc with an engraving that depicts the globe which serves as a background to a naked man with an open book laid on a cloth over his lap, his left hand pointing into the book, his right hand raised upwards. Altogether it symbolises the Centre's nature as an institution where people think, learn and communicate their knowledge to whoever are interested, to share it with them, mankind the world over being their concern and the globe their horizon. The nakedness symbolises the open-mindedness, the absence of prejudice, in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "*Nalar Ajar Terusan Budi*", which in the Javanese language essentially means that to think and to share knowledge are only the natural consequence of an enlightened mind. It is a *surya sengkala*, that is *chandra sengkala*, a Javanese traditional way to symbolise a memorable year in the lunar calendar, adapted to the solar calendar system. It consists in using words that express the perceived meaning of the commemorated year while marking the year at the same time, each word having a numerical value. Thus, the inscription, in reverse order, represents the year the CSIS was established: 1971.

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Current Event

RI-Australia Ties: What Went Wrong?*

Hal Hill & Chris Manning

AS the Timor crisis deepened, relations between Australia and Indonesia soured, and then deteriorated seriously, sharply and unexpectedly in September-October 1999.

After a decade of seemingly positive and broad-based expansion, developing into what some came to regard as an emerging “special relationship”, these two months witnessed unprecedented recrimination and antagonism. Although an open, formal rift was avoided, the cooling of relations was reflected in public statements made at the highest level.

President Habibie referred in the Indonesian parliament to Australia’s unwelcome “interference in Indonesian affairs”, while Prime Minister Howard spoke of the need to assert “Australian values” in the region, rather than kowtowing to the policies of neighbors, referring (implicitly) especially to Indonesia.

At the heart of the matter was the crisis in East Timor. The extensive and almost instantaneous coverage by the international

electronic media of the tragic events in Timor, together with its tendency to highlight isolated and extreme reactions in both countries, heightened the sense of crisis. It contributed to emotional responses. Australian unions boycotted Indonesian ships, and Garuda passengers were harassed; the Indonesian flag was burnt, and the Indonesian Ambassador could not enter his office for over a week.

In Indonesia, in response, there was an almost continuous demonstration outside the Australian embassy, seemingly (if TV shots were to be believed) verging on violence. Australian offices were attacked and Australian citizens threatened. At the nadir of the relationship in early October 1999, Indonesians saw Australia –seemingly too enthusiastically– take the lead in the formation of a multinational force, UNAMET, to restore order following the post referendum militia rampage in Timor.

But many Indonesians saw Australians zealously entering “their territory” (as most Indonesians regarded East Timor then), and behaving in a militaristic and bellicose fashion –the armed Australian soldier standing

*This article was published in *The Jakarta Post*, 30 November and 1 December 1999.

over the defenseless Timorese youth, for example.

How and why was the relationship so easily and quickly derailed? And where do we go from here? Answers to these questions are important, not just for Australia and Indonesia but, more broadly –since the two countries are the dominant powers of the South Pacific and Southeast Asia respectively– for the harmony of the region.

It was not just the Australian actions which angered many Indonesians. Australia's style was unpalatable. Indonesia expected its neighbor to show some understanding of Jakarta's predicament (at least that of a weak civilian government), and to help calm the situation. But instead Australia appeared to take the lead in condemning Indonesia. The voice of Australia –its media, its politicians and its people– appeared more strident than any other. Even liberal-minded and sympathetic Indonesian figures, such as Sarwono Kusumaatmadja and journalist Wimar Witoelar, saw Australian reactions as "arrogant" or "insensitive", its words and actions smacking more of a colonial power than an understanding neighbor.

Conversely, in September, Australian watched each night on television the abuse of a poor and innocent people, whose only "crime" was that they clearly and decisively voted for Independence. Why couldn't the all-powerful Indonesia military assist these people and control the violence, Australians (and indeed the world) asked. Why was the government in Jakarta so seemingly two-faced in response to international criticism?

The immediate cause of tension –a process of decolonization, strongly opposed by elements of the Indonesian military and equally strongly supported by large sections

of the Australian public, and by their government– which erupted in violence, was as difficult a problem as most neighbors will ever face.

In one sense, it was a credit to the leaders of both countries that diplomatic relations remained open, despite many calls from their domestic constituencies for radical action. But beyond the immediate rift, ill-informed recriminations and the proliferation of stereotypes revealed that there is still a fundamental lack of understanding of national characteristics and political processes in each country –a lack of understanding which was all too easily manipulated by mischievous elements on both sides. Among these caricatures of each other, Indonesians often view Australians as white, racist, rich, arrogant, and possessing an unrivaled propensity to lecture other countries.

On the other hand, many Australians continue to view Indonesia (even after fall of the Soeharto) as corrupt, brutal, militaristic, authoritarian, and maintaining an iron grip on a reluctant non-Javanese citizenry in the eastern provinces. Like all caricatures, there is an element of truth in these views. But as generalizations they are seriously distorted. Many Australians, especially in the media, failed –or did not want– to recognize, the broad-based improvements in Indonesian living standards since the mid 1960s, across both socio-economic groups and its far-flung regions.

Australians have also tended to pay scant attention to deep historical and cultural sensitivities. Having never been a poverty stricken colony, never been invaded by a foreign power, and never had to fight a protracted and bloody war of Independence, most Australians do not have the historical

perspective to understand Indonesian sensitivities on key issues. Flag-burning, for example, arouses little passion in Australia, yet for most Indonesians it is a highly provocative action. With a hard-fought Independence achieved just two generations ago, destruction and defamation of national symbols by a neighbor is quite shocking to many Indonesians.

The fact that Australians are predominantly rich and white, and are culturally disposed towards frank and blunt expressions of opinion abroad –mirroring the style of domestic debate– further complicated the issue. These misperceptions work in both directions, however. It is true that Australia maintained a discriminatory immigration policy until about 1970 (the so-called “White Australia Policy”), and that for the first 180 years of European settlement the treatment of aboriginal people was disgraceful. But things have changed much in Australia over the past 30 years. Australia now has an open, non-discriminatory immigration program, matched by very few countries. The resulting societal transformation has been rapid and Australia is arguably one of the world’s most vibrant multi-cultural societies.

Its generous refugee program has few parallels, certainly in this region. It is true that this “multiracialism” has been strongly criticized at home – the “Pauline Hanson” factor. But the immigration program continues to attract bipartisan political support. The One Nation party is now in decline and never captured votes on a scale comparable to similar parties in the U.S. and Europe.

It is also true that Australia’s aboriginal community (numbering about 250,000 persons) have unacceptably low living standards. But there are many “positive discri-

mination” programs and the community’s problems are openly acknowledged and debated within and outside government. In addition, Australia continues to be one of the major donors to Indonesia, including a generous scholarship program. It strongly supported the international financial rescue effort in the wake of the economic crisis and, despite fiscal austerity at home, the real value of aid has been broadly maintained. Australia’s per capita income is now below both Singapore and Hong Kong, neither of whom provides aid to Indonesia.

The Australian press is often seen as a complicating factor in bilateral relations. It is easy to understand Indonesians’ anger here: in recent times, the extraordinarily rude and ill-informed television interview with the Indonesian ambassador on a commercial network, and the *60 Minutes* team crassly walking into a “minefield” by asking queuing East Timorese how they would vote in the referendum. More generally, many Australian journalists, with their single-minded focus on human rights, East Timor, and corruption, have failed dismally to present a balanced picture of the complexity of Indonesia. There is no doubt that, rightly or wrongly, the murder of five journalists in Balibo in late 1975 has contributed to this press hostility towards Indonesia. But, while Indonesian dismay is quite understandable, here too the issue is not amenable to sweeping generalizations. There have been some very fine Australian journalists in Indonesia, particularly in the print media.

Indonesia’s sometimes heavy handed press controls needlessly antagonized the foreign (and of course the domestic) press. And the problems with the Australian press have arisen in part from proximity and fam-

iliarity. *The New York Times*, London's *Guardian*, Dutch papers, the *BBC* and *CNN* have often been just as critical as Australian outlets. But because there are not as many of them, and they do not report as often, the tensions have not been so great.

Where do we go from now? Recent experience has surely taught us that there are no quick fixes. Unrealistic expectations of close bilateral relations, frequently based on impractical hopes of commercial advantage, built up in the 1990s, especially in the Keating years.

There is not yet enough commercial advantage on both sides to make this a binding force. Nor is there a clearly dominant partner in the bilateral relationship, or a long history of previous conflict and learning to live together, factors which have mitigated against conflict in recent times in countries such as France and Germany, or Japan and China.

Australia and Indonesia need to work together because of propinquity. It is easier to get on in the world, and in the region, if there is no constant friction in one's own backyard. This will not be easy. Leaders and people in both countries need to recognize that, because of huge differences in "initial conditions" (economy, institutions, history, religion, cultures), it will take generations to build the necessary broad-based, people-to-people understanding. It will be a long time before close and secure ties are able to withstand the vicissitudes that are, inevitably, an occasional feature of the bilateral relationship.

Arguably, Australia needs Indonesia more than the converse, although many Australians balk at this proposition (It rankles with some that Australia, in spite of its wealth

and more developed political institutions, must sometimes defer to its more populous and internationally influential neighbor). Australia is the smaller country and, in the eyes of many in the region, the "intruder" in Asia. Indonesia is a natural bridge for Australia to countries in Southeast Asia and beyond. So the ball is first and foremost in Australia's court.

Three special challenges face Australia. *First*, while there are high hopes for democracy in Indonesia, Australians need to be prepared for temporary setbacks, given the extraordinarily difficult transition from such an autocratic regime. Australia will need to achieve a balance here: between affirming support for universalistic values, without seeming to lecture when things do not go smoothly. The management of its relations with Indonesia and other countries in the region depends critically on Australia achieving a better balance here. Certainly, Howard's bland announcement that Australia wishes to promote and defend "Australian values" in the region is not an encouraging start.

Second, the fall of Soeharto, a much weakened military, and East Timor's independence have increased the probability of center-region conflicts which may threaten the unity of the Indonesian state. The case of Aceh is evident enough. The prospect of increasing tensions in nearby Irian Jaya will require a sensitive Australian response. As Professor Nancy Viviani recently argued at the Indonesia Update conference in Canberra, Australia will need to recognize fundamental historical differences in Indonesia's view between Irian Jaya and East Timor: that is, a staunch commitment to the former Dutch colonial territory as an integral part of modern Indonesia.

Finally, there are bound to be on-going conflicts as East Timor searches for a new political format, and seeks to promote development in the shadow of its more powerful neighbors. We can be certain that East Timor will remain more than a "pebble" in Australian-Indonesian relations, even with the best of possible outcomes: a quick reconciliation and genuine efforts at cooperation between the Timorese and Indonesian governments.

The bitter legacy from the armed conflict and human rights abuse, and the potential disruption from cross border skirmishes, will sorely test diplomatic relations. Avid supporters of the Timorese case in Australia are likely to push for stronger condemnation of Indonesia, or for Australian government responses which could severely damage Australian-Indonesian relations. This is not to argue, of course, that Australia should always bow to Indonesian "pressures", or to ignore the human rights of the Timorese. The bottom line is that Australia will need a new framework and greater sensitivity on all these issues that remained cocooned during the Soeharto years.

On East Timor, it seems important to establish a special multilateral framework, similar to a donor's group, and ideally involving Indonesia. This would help avoid conflicts which could threaten frequent and serious derailment of Australia-Indonesian relations. A more democratic and open Indonesia can be expected to recognize Australia's new challenges in relations with East Timor. Relations with Australia will never rate high on the Indonesian foreign policy agenda. But Australia can be a valuable partner through its considerable knowledge of and interest in Indonesia (and Southeast Asia), and the density of people-to-people

relations, which are greater than with any other western country. It would be hoped also that, in time, many more Indonesian leaders, intellectuals, and ultimately politicians might appreciate this potential. In the immediate future, rather than sustaining a "top-down" special relationship, the task for governments is to work quietly to develop deep and broad-based bridges across the Arafura.

The need is for quite modest initiatives, such as school programs and exchanges, press interactions, and contacts between the artistic, scholarly and professional communities in each country. Australia's aid program should of course be maintained (and not diluted to make way for assistance to East Timor), including as a special feature a commitment to building Indonesia's educational capacities. Business ties should also be encouraged, although the "cargo-cult" mentality that appeared to develop in both countries (but especially Australia) over the past decade should be hosed down. Thus, in summary, maintaining good and productive relations is a major challenge for our two governments.

People-to-people relations will be critical in getting over the inevitable hurdles as we move forward, while recognizing that the cultivation of a deep and broad-based understanding in each country will take much longer. For a still small number of Australians, Indonesia has been the first engagement with a truly different, and enormously rich, society and culture. Hopefully many more Australians will come to appreciate this richness, and more Indonesians for their part will benefit from deeper contact with the open and multiracial society of Australia.

Indonesia and the Future of ASEAN*

Rodolfo C. Severino

EVER since President Soeharto stepped down as Indonesia's leader in May in 1998, the media and others have often asked: Now that President Soeharto is no longer in power, and now that Indonesia is in transition, what will happen to ASEAN? President Soeharto, after all, was the last of ASEAN's founding fathers to leave office, and Indonesia under the New Order was perceived as ASEAN's leader.

The answer to such questions has been this: ASEAN is already a going concern. It no longer depends, if it ever did, on individual leaders. In the case of Indonesia, the policies and attitudes that Indonesia under Soeharto brought to ASEAN have been long in place. There is no sign that these are changing. At the working level, ASEAN has not missed a step as a result of the change of leadership in Indonesia. Indonesian participation in ASEAN has not diminished.

Indonesia, indeed, has been and continues to be important to ASEAN, but not in the

shallow and simplistic terms in which many commentators present it today, not in the superficial sense of Indonesia being ASEAN's leader because of its size and the qualities of its leader.

What Indonesia brought to ASEAN at the time of its birth was something that gave ASEAN weight, strength and direction, something indeed that made ASEAN possible. This was the transformation of policy and attitude that Indonesia underwent and that brought it in step, along with the rest of non-communist Southeast Asia, with the demands of the times. Indonesia, by 1967, had transformed its economic policies and its attitude toward its neighbors and the world at large. The new priority was development, and whatever it took to achieve it, domestically or internationally. A large dose of pragmatism was the order of the day.

From a statist, mercantilist, import-substituting economy, Indonesia's economy had started to move to one that was market-driven, export-oriented and open to foreign trade and investment. Its foreign policy had shifted from one that was confrontational toward its neighbours and defiant of the West to one that placed great value on co-operation with its neighbors and good relations with the world beyond, including the West.

*Keynote address by H.E. Rodolfo C. Severino, Secretary-General of the Association of Southeast Asian Nations, at a conference on "ASEAN Into the New Millenium: The Road Ahead" sponsored by the Indonesia Council on World Affairs in co-operation with the Department of Foreign Affairs of Indonesia and the ASEAN Secretariat ASEAN Secretariat, Jakarta, 26 August 1999. The address has been edited for publication purpose.

Without such a transformation of economic and foreign policy in Indonesia, ASEAN as we know it would not have come about. If Indonesia had maintained a relatively closed economy, relying on commodity exports, resorting to import-substitution and dominated by state enterprises, the degree and kind of ASEAN economic cooperation and integration that we have today would not have been possible. ASEAN would not have been open to and plugged into the global economy the way that it is now. If Indonesia had kept to its narrowly nationalistic posture toward the world and retained its suspiciousness toward its neighbours, the level of mutual trust and regional identity that are the key to ASEAN's success could not have been attained.

Indonesia's Importance

This is the importance of Indonesia to ASEAN, rather than one man's leadership or Indonesia's size alone. There is no sign that this basic policy orientation of Indonesia or its fundamental commitment to regionalism has diminished despite the political changes that the country is undergoing.

At the same time, after the turmoil of 1965 and 1966, Indonesia made clear its continued adherence to a national policy of ethnic, racial and religious tolerance, of unity in diversity, that had kept -- and continues to keep -- the nation together. This had a reassuring effect on its would-be partners in ASEAN, all of whom, in one form or another, to one degree or another, were blessed with ethnic diversity and threatened by ethnic division. Any erosion of this policy of tolerance in Indonesia would have ignited fears of contagion in its neighbors, which might have led them to seal themselves off from

Indonesian influence. Divisiveness in Indonesia might thus have led to unbridgeable regional divisions in Southeast Asia.

Moreover, Indonesia, in its wisdom, allowed itself to wield its already considerable weight in the world in the new context of ASEAN. In this way, ASEAN has been able to avoid the problem of some other regional associations, which are hampered and burdened by the dominance of their largest members. Instead, Indonesia's international influence, prestige and activism, magnified by its new internationalist posture, were to be placed in ASEAN's service -- at the United Nations, in the Non-Aligned Movement, in the Group of 77, and in other international forums.

Indonesia and the ASEAN Way

In terms of style and approach, the Indonesian insistence on *musyawarah* and *mufakat* firmed up the preference of the other Southeast Asians for consultation and consensus as the mode for regional decision-making. Any other mode would have made agreement in ASEAN much more difficult, if not impossible, rather than easier and more quickly, as some superficial media and academic commentaries assert these days. This has come to be known as the ASEAN way, which has put its stamp on the ASEAN Regional Forum and APEC. The Indonesian concept of national resilience and regional resilience reinforcing each other strengthened the Southeast Asian conviction about the close linkage between political stability and economic development at both the national and regional levels.

Thus, responding to the demands of development, the five founding members of

ASEAN -- Indonesia, Malaysia, the Philippines, Singapore and Thailand -- gave primacy to economic considerations in their domestic and external policies. As a matter of basic economic policy, they opted for a stance that favored market forces, albeit with a significant measure of state intervention, an enlarged role for the private sector, the export of processed goods as well as commodities, the import of capital goods and industrial raw materials, openness to foreign investment, and an active quest of foreign grants and credits. They chose to advance the security of the region, as well as their own national security, by forging constructive relations, both among themselves and with the rest of the world, rather than by taking sides in the cold war or by a posture of confrontation. They decided that, for the sake of regional solidarity, they would isolate any bilateral disputes from their overall relations with one another. They sought economic progress and political stability in significant measure through regional co-operation and solidarity. This was to be the basis for ASEAN's eventually robust viability, and it was made possible by Indonesia's reversal of its fundamental policy orientation prior to ASEAN's founding. Similar reversals were to open the way for the membership in ASEAN of other countries in Southeast Asia.

The road that ASEAN took led to a degree of success that even its founders did not dare to envisage. ASEAN has been able to manage the immense diversity of Southeast Asia, with its host of bilateral disputes, so that conflict between its members has become all but unthinkable. The Southeast Asia Nuclear Weapons-Free Zone is now in effect, with consultations going on for the accession of the nuclear-weapon

states to its protocol. The ASEAN Regional Forum is now a going concern.

ASEAN has achieved a substantial level of economic integration despite the scepticism of many through the years. For the six original signatories to the AFTA treaty, which are ASEAN's leading trading nations, the ASEAN Free Trade Area will be completed in less than two and a half years. ASEAN members have decided to open up their manufacturing sectors to ASEAN investments and to extend national treatment to such investments. They have agreed on a common set of incentives, in addition to their respective national measures, for investments from outside the region. Over the years, ASEAN has developed networks of co-operation that have been increasing its capacity to deal with growing transnational problems involving the environment, transnational crime, human resource development, and the promotion of social safety nets. It has achieved a high degree of co-ordination in the councils of the world.

The recent financial crisis has put ASEAN to its severest test in decades, and for now ASEAN seems to have overcome the worst of it. Commentators outside and even in Southeast Asia, many of whom should have known better, predicted that ASEAN would fall into disarray, if not break up, as a result of the crisis. Contrary to these instant predictions, ASEAN has pushed forward the integration of Southeast Asia's economies. It has accelerated the completion of AFTA. ASEAN members have agreed to open up their economies further to ASEAN and other foreign investments. They have been co-operating closely on financial matters, particularly through the economic surveillance process. They have resolved to help one an-

other to cushion their societies from the severest impact of these and future crises.

Deeper Integration and Closer Co-operation

ASEAN countries know that deeper economic integration and closer co-operation are essential for them to deal with the rest of the world from a position of greater strength, attract investments into the region, stimulate economic activity, and develop greater competitiveness in a globalized economy.

There is now a feeling of relief in ASEAN that the worst of the crisis is behind us. But there is also a feeling that, in the wake of the crisis, ASEAN will not be the same any more. The crisis has exposed, in Indonesia most starkly, the need for ASEAN countries to undergo changes in the way they conduct certain of their affairs if they are to cope with the reality of globalization.

ASEAN is, of course, all too aware of the need to make changes in the way the international community conducts its financial affairs, and ASEAN has made known its position on this subject. But ASEAN countries also know that they themselves must now enter into a new stage in the development of their economies and their societies. The old ways of doing things, no matter how well they seem to have served ASEAN in the past, will no longer do.

As mentioned earlier, the ASEAN countries adopted in the 1960s domestic and external policies that were responsive to the needs of the times. But they also made available an environment in which business was conducted and wealth created largely on the basis of personal relationships and cozy

networks of politicians, bureaucrats, tycoons, and financial establishments, with few institutional checks and a great deal of opaqueness. Despite growing discontent over the inequities that resulted from the system, this was tolerated and, in those sectors that benefited from it, accepted with enthusiasm, as long as it was fuelling rapid growth that somehow filtered down to enough people.

Changing the System

However, the crisis has shown that such a system will no longer do in an era of rapid technological advances, economic globalization, heightened competition, and capital flows of growing volatility. Doing business and promoting development now have to be both more rules-based and more market-driven. Therefore, institutions must be developed -- political and judicial as well as economic. This means that the private sector must be built up, and strengthened where it is weak. This also demands the development of the human resources to master modern technology and professional management, to navigate the straits and shoals of market forces, and to build and manage institutions to supervise and adjudicate financial and other economic transactions in a fair and objective way.

The development of the private sector and of human skills requires and reinforces two things -- the enlargement of the middle class and a certain degree of pluralism in society. In some cases, opening up the economy to the global or regional economy and to market forces may not be enough. Adjustments in the political and/or social order may have to be made, as is happening in Indonesia. Such adjustments could unsettle nations and societies, at least temporarily.

Expectations of and pressures for change rise within the middle class that already exists and among people who are already politically aware. This is now taking place. But, in the longer term, greater openness, pluralism, a larger middle class, and a strengthened private sector would likely lead to greater national stability.

On the other hand, some leaderships, for any number of reasons, may resist the logical consequences of opening-up and reform and the lessons learned from the crisis. Or they may be unable to carry them out, because of political inertia or social sclerosis or some other reasons. In such cases, the economy may bog down. In any case, the development of human resources and the building of institutions, including a private sector, take time:

Either way, the demands of our time, as shown by the crisis, have raised the pressures for political and social, as well as economic, change. Such a change could be unsettling, particularly in those countries where the road to a rules-based, rule-of-law, market-oriented, private sector-driven society is longest. The transition could bring about temporary instability, if long-term stability. But, the crisis has taught, if the transition is not made, the economy could stall. The gap between ASEAN nations could, as a result, widen further -- the gap in development, in institutions, in human resources. This is a phenomenon that ASEAN is addressing, but it takes time and considerable resources.

Another Indonesian Transformation

In the regional context, a transformation in Indonesia is, once again, required, if ASEAN as a whole is to negotiate the trans-

ition. The exacerbation of the traditional inter-state differences between Indonesia and any of its neighbours as a result of the changes going on in Indonesia or in its neighbors does not seem to exist. But, as in 1966-1967, how Indonesia manages its own transition and its own affairs could have a profound impact on ASEAN's future.

Some political and social untidiness can result from the opening-up and growing pluralism of Indonesian society. But Indonesia will likely emerge from it all a more stable nation. Only a stable Indonesia can continue to contribute significantly to ASEAN's steadiness and balance. Only a stable Indonesia can continue to play a leading role in international affairs, which has been one of Indonesia's principal contributions to ASEAN's international influence and prestige.

Indonesia will probably regain its steady growth, this time by building and rebuilding and strengthening its vital institutions -- the legislature, the courts, the economic and financial supervisory bodies, the law-enforcement agencies, the political parties, the corporations, the banking system. How Indonesia gets back on the road of growth, and to what extent, will obviously influence the rest of Southeast Asia.

How Indonesia handles military-civilian relations and the role of the military in politics could have an influence, too, on parts of Southeast Asia and beyond. How Indonesia manages diversity and how it accommodates ethnic aspirations and regional interests in the national polity and in the national economy could have an impact, in unforeseen ways, on some of its neighbours, on the stability of the region, and on

ASEAN itself. Others in the region will closely watch how Indonesia deals with issues of human rights and political participation.

What the crisis has taught is that Southeast Asia must enter upon a new stage of modernization, as Indonesia is trying to do. Southeast Asia must do so in its own way, of course. Indonesia, for one, has always been an advocate of development according to one's own circumstances, culture, national philosophy and history. But the way to development, whatever it is, must be effective in strengthening the nation, laying durable foundations for progress, and improving the lives of the majority of the people.

Nowadays, at the threshold of a new century, what this means in Southeast Asia is progress toward more open and more plural societies. Greater scope for private initiative. More and fairer competition in the marketplace. Government and management by law, rules and institutions. A larger measure of accountability on the part of governments, corporations and financial institutions. Greater transparency in political and economic transactions. The accommodation of human diversity and regional aspirations. The development of human skills and of the human potential.

Not least, it also means a strengthened commitment to regionalism. Once again, as in 1967, such a commitment is essential from Indonesia. Because today a hundred flowers are blooming and a hundred schools of thought are contending in Indonesia, it is no longer possible to take a continued Indonesian commitment to ASEAN for granted, as it was until the recent past. But surely from the free contention of opinions will emerge a renewed Indonesian engagement in ASEAN and a revitalized spirit of regionalism in Indonesia.

This is because the Indonesian people know that a market of regional dimensions will more effectively attract investments back to the country. They know that only with ASEAN's weight behind it can Indonesia continue to exert its considerable influence in the world. Only with regional peace and stability can the Indonesian people negotiate the road of development, which is always arduous, but particularly so in these difficult times. Only through regional co-operation can they deal with many environmental and social problems, which are increasingly regional in scope. The Indonesian people know, in their wisdom, that regional solidarity in a vigorous ASEAN is essential for its own stability and prosperity in an uncertain and fiercely competitive world.

ASEAN's Relevance: Has It Become Questionable?

C.P.F. Luhulima

THIS question can be answered promptly by stating that ASEAN is still very relevant in the field of politics and conventional security, to moderate political and security disagreements among members. It seems, however, to be less relevant in the field of economics.

ASEAN's Major Objectives

ASEAN's major goals as set out in the 1967 Bangkok Declaration were first to reconcile intra-regional strife which characterized Southeast Asia at the time (in the form of border and territorial disputes, ethnic conflicts and animosities, religious prejudices, and the fear of smaller states of the bigger states). Second was to manage those conflicts and tensions and create a Southeast Asian regional order on the basis of the social and economic systems of each member country and the territorial *status quo*, and thus to "promote regional peace and stability". Both goals were to be achieved by way of a third goal, which was to speed up "the economic growth, social progress and cultural development in the region". ASEAN's founding fathers were confident that economic and societal development, on the one hand, and peace and stability on the other, were tightly linked. They are further determined, and this is their fourth goal, "to ensure their stability and security from external interference in any form or manifes-

tation" to "preserve their national identities in accordance with the ideals and aspirations of their peoples".

These four major goals of regional endeavours in Southeast Asia were subsequently cast into four instruments for political and security build-up: *The ASEAN Declaration*, *The Declaration on the Zone of Peace, Freedom and Neutrality* which was primarily meant to secure the recognition and respect for Southeast Asia as such a zone, *The Bali Concord* and ZOPFAN's legal instruments *The Treaty of Amity and Cooperation in Southeast Asia* and *The Treaty on Southeast Asia as a Nuclear Weapon Free Zone*, which was meant to promote perpetual peace, everlasting amity and cooperation among the Southeast Asian nations. These instruments formalised ASEAN's role as an important contributor for peace and stability. Economic cooperation programmes only started after the signing of the *Bali Concord*. ASEAN was thus, on the one hand, the materialisation of its members' recognition of their inability to solve their disputes and conflicts bilaterally, while, on the other hand, it was meant to serve as a political-cum-security framework.

Since the establishment of the Association, ASEAN member countries have proved that they are capable of co-existing in peace and harmony. Although regional disputes

and differences have not been resolved, ASEAN countries have learned to diffuse or abate their conflicts and not to exploit it for their own interests at the cost of the Association. Hence, ASEAN's existence is a security guarantee for peaceful and harmonious bilateral relations, and as a corollary for long-term economic development, social progress and cultural development.

It has become increasingly difficult to visualise a conflict between two or more ASEAN member states. Sub-regional relations have developed an ASEAN spirit, which strongly supports ASEAN regionalism. Despite the legal character of the Treaty of Amity and Cooperation in Southeast Asia, ASEANist preference is for informal approaches to solving conflicts, placing emphasis on relationships rather than on formal structures; and emphasizing consensus building. There is a general distrust for a structured and legalistic manner of approach to conflicts without sufficient consideration of the situation and the emotional state of the conflicting parties. But can this aversion to structured and legal approaches hold in the 21st century, which will be complicated by the deluge of globalisation and fierce competition and as a corollary by the multilateralisation of security approaches and multidimensionalisation of threats to security?

Multilateral Security Approaches

Multilateral security organisations in Asia were born during a period of great geo-political change. The disintegration of the Soviet Union and the end of the Cold War in combination with the U.S. departure from its bases in the Philippines provoked considerable uneasiness among political and security specialists in Asia on the fut-

ure of regional security in the post-Cold War environment. The result was a proliferation in the early 1990s of official and unofficial multilateral security dialogues intended to address the imperatives of a new multipolar world. Academics and scholars were the driving force behind many of the first dialogues, including the Council on Security Cooperation in the Asia-Pacific or CSCAP, established in Kuala Lumpur in June 1993, and the Northeast Asia Cooperation Dialogue or NEACD, established in California later that year.

The most important of the organizations that emerged from this ferment was the ASEAN Regional Forum (ARF), the first region-wide consultative body in Asia focusing on security issues. In 1993, the Clinton Administration reversed previous policy of hostility to multilateralism and joined with ASEAN as a founding member of the ARF.

The great variety of actors in the region and the great number of strains and conflicts induced the ASEAN Regional Forum (ARF) to provide the region with an institution to absorb multilateral dialogues on security and to develop further the concepts of confidence building, preventive diplomacy and finding ways to resolve regional tensions and conflicts towards developing instruments for conflict resolution in the region on the model of TAC. The need to maintain stable relations among the major powers, which is a crucial and integral element underpinning regional stability, should be continuously emphasized and operated.

The ASEAN Regional Forum in its first session in Bangkok (25 July 1994) agreed to accept the objectives and principles of TAC as "a code of conduct governing relations between states and a unique diplo-

matic instrument for regional confidence-building, preventive diplomacy, and political and security cooperation". (Par. 6) At the 6th ARF in Singapore (25 July 1999) members recognized TAC as "a key regional instrument for strengthening security in the region". This will involuntarily promote the development of a "region-wide code of conduct". (Par. 10) Following this line of thought, the acknowledgement of non-Southeast Asian countries of the *Treaty on Southeast Asia as a Nuclear Weapon-Free Zone* is expected to contribute to the comprehensive denuclearisation of the region.

Multidimensional Security Approaches

The post-Cold War developments in the Asia Pacific region have also created new disturbances and threats, beyond the conventional field of foreign policy and security. It has expanded the threat dimensions to sustainable development and democracy. It is this complexity that creates the need to multidimensionalise the concept of security, comprising those aspects of security against narcotraffic, international crime, formerly dubbed low intensity threats, and increasingly against environmental degradation, biodiversity loss, emerging diseases, overpopulation, and political unrest as a consequence of these new kind of threats.

Biodiversity loss is the fastest moving of all environmental problems and it is irreversible indeed. It hampers future prospects of achieving stability as well. So is environmental degradation, which is a threat driven by production and consumption of goods and services in a manner that is not environmentally benign, such as the haze problem caused by forest fires in Kalimantan and Sumatra since 1997 (which for

some time questioned the seriousness of the Indonesian government to solve what is increasingly seen as a sustained crisis). This will need the institutionalisation of a disaster management mechanism. Emerging diseases are also a threat to security. Infectious diseases affecting humans, plants and animals, which are spreading rapidly as a result of trade and travel, and -- amplified by malnutrition -- threaten the public and productivity on a broad and intensive scale. Still another is overpopulation as a consequence of population growth. It is putting excessive demand on human and physical capacity to meet human needs for food, housing, health, employment, and education. Finally, political unrest and its consequences. Warfare, ethnic and social clashes set back efforts to meet critical human and environmental needs. They tend to be regional problems with global impact as a consequence of forced migrations and other disruptive effects.

The unpreparedness of Indonesia and other ASEAN countries to recognize and deal with the new dimensions of security straightforwardly is complicated by the emergence and widely applied concept of human security. The latter term means safety for people from challenges, threats, and disturbances, both violent and non-violent. The principal and conventional objective of national security is the protection of national territorial integrity and political sovereignty from external aggression. It is now considered to be insufficient in guaranteeing people's security. The concept takes people as its point of reference rather than focusing exclusively on the security of territory or sovereignty. Human security (which also emphasizes that women are equal partners of men in all walks of life and throughout

their life cycle) entails taking preventive measures to reduce vulnerability and minimize risk, and if prevention fails take remedial action. A human security perspective thus asserts that the security of the state is not an end in itself.

The concern for human security as concern for the safety of people extends beyond national borders. It is seemingly a logical extension of current approaches to international peace and security. The UN Charter embodies the view that security cannot be achieved by a single state in isolation. The term "international peace and security" implies that the security of one state depends on the security of other states as well. A human security perspective seemingly builds on this logic by noting that the security of people in one part of the world depends on the security of people elsewhere. It seems to imply that the security of states and the maintenance of international peace and security are ultimately constructed on the foundation of people who are secure. Human security will thus have to be incorporated in the dimensions of national and regional security in the Southeast Asian region.

Economic Approaches to Security

ASEAN's economic relevance came starkly into question during the dramatic financial crisis. It failed to find answers to the breakdown in their financial and economic systems (to their weak financial systems, to their excessive unhedged borrowing by the private sector and to the lack of transparency in government and corporate sectors); each member resorted to individual approaches to safeguard their own interests. Each member tried to overcome the crisis individually; each in co-operation with global

financial institutions, the IMF and the World Bank, and each followed their own prescriptions for economic recovery. Their leaders often contradicted each other on the basic policies they earlier agreed upon. It was even feared that relations with neighbors might be sacrificed in the process of finding solutions to domestic instabilities. These developments have turned the attention of member states inwards and as such made intra-ASEAN relations less cohesive, and indeed pointed to the resurface of long-standing tensions among member states.

Although ASEAN leaders met in December 1997 in the light of the crisis, and although they acknowledged that the depreciation of their currencies had resulted in serious regression in the economic well-being of their countries, their business, and their peoples, they had failed to outline or pursue a united approach towards the IMF and the World Bank in dealing with the crisis. They only stressed "that ASEAN countries must remain united and show resolve in responding to the challenge posed by the currency situation".

These developments have led to the view that the association lacks the resilient mechanisms to handle the dramatic impact of the crisis and justified the question of ASEAN's further relevance for the countries in Southeast Asia. It came short of the establishment of an ASEAN Surveillance Mechanism, which may constructively propose to a member country to modify its financial-economic policies, which may have adverse effects on its neighbors or the region as a whole.

The Hanoi Action Plan was an attempt to again commit themselves to greater integration of their economies as a primary ex-

pression of our cooperation and solidarity. The major thrust of the Hanoi Action plan is to enhance greater economic integration and the speedy creation of an ASEAN economic region. ASEAN leaders will spare no efforts to quickly restore financial and macroeconomic stability, bringing about early economic recovery and maintain sustained growth. ASEAN will continue with its open market policies, with its commitment to trade and investment liberalization and facilitation, as it recognizes that long-term investments are the key to strengthening and stabilising the region's currencies and economies. ASEAN has also boldly committed itself to accelerate AFTA, the ASEAN Industrial Cooperation Scheme (AICO) and ASEAN Investment Area (AIA) with consistent investment laws and policies. It is meant to regain business confidence, enhance economic recovery and promote growth. A most important decision is the wider use of ASEAN currencies in intra-ASEAN trade settlements, which was agreed in 1997. These commitments will be supported by further development of regional infrastructures such as networks of electricity grids, gas and water pipelines, and transport and telecommunication links, which will enhance ASEANs competitiveness.

The great scope and ambition of the programmes raise the question whether ASEAN will be capable of massively mobilising the political will and resources in time and execute them with great determination. Unilateral approaches to face and handle the crisis still predominate in ASEANist member countries.

The latest developments have shown that ASEAN's AFTA program is more political economy rather than real economy:

it is an attempt to provide an adhesive for intra-ASEAN relations rather than a genuine mechanism for trade liberalization and facilitation. Even APEC has not been able to provide the necessary conditions for trade and investment liberalization and facilitation. It seems to have lost its momentum. APEC's Summits have evolved into a talking shop for issues unrelated to trade, particularly to trade of the developing countries. They have developed into discussion on topics of liberalization and facilitation that are more of interest to developed APEC members. Moreover, in the past three years APEC forums were dominated by non-trade issues: the financial crisis in 1997, the Anwar Ibrahim case in 1998, and the East Timor case in 1999.

The World Trade Organization seems to be a better choice to liberalize and facilitate trade and investments policies of its members. So if AFTA is to serve as an instrument for trade liberalization, then it has to be opened for a wider commitment which means that it has to be integrated into the WTO framework.

Wither ASEAN?

ASEAN has developed a well-tested mechanism for cooperation and coordination in facing conventional threats under favourable economic conditions, but it was paralyzed by the crisis and has since not been able to devise and develop a mechanism in times of crisis, to face conventional and non-conventional security threats. ASEAN will not be capable of solving its conventional and non-conventional threats if it is unable to design and develop a new institutional infrastructure to face conventional and non-conventional security threats alike in unfavorable circumstances, in line

with the concepts of national and regional resilience, of comprehensive or total security or redefine or redesign existing institutions.

The severe financial and economic crisis which had profound effects on the security outlooks and designs of the ASEAN countries seemed to have shattered ASEAN dreams and simultaneously exposed the fragility of its security outlook and doctrine and of ASEAN as a regional institution. It has failed to provide immediate answers to the economic collapse. ASEAN has not yet given clear signals whether it will lessen its economic and political divergencies, whether it will promote domestic and regional stabilization simultaneously to recapture its bargaining power *vis-a-vis* its dialogue partners and external powers in general.

It is from the political and security realm that ASEAN will have to recapture its strength, to safeguard the region from internal and external threats to its development, to its modernisation program and processes as a consequence of unfettered globalisation and fierce competition. It still has a very important role to play to guarantee the security of searoutes of communication for the trade and commerce of any member country. However, the expansion of the security spectrum simultaneously made it possible for external forces and states and international institutions to intervene into the internal affairs of Southeast Asian countries, particularly in the name of human security, sustainable development and democracy. And it is here that ASEAN will have to strike that precarious balance between recapturing its collective strength and set the conditions for external interventions.

What ASEAN needs to work for is factoring the non-conventional threats and

threat perceptions into the existing security instruments or design new instruments to comprise the new sources of threats. The security concepts and outlook and the recent developments clearly indicate that it will be very difficult indeed to sustain an artificial dividing line between the various dimensions of security and the levels on which they operate. It will also become increasingly difficult to refuse outright the proposal for "constructive intervention" (Anwar Ibrahim) or "flexible engagement" (Surin Pitsuwan -- *Thailand's Non-Paper on Flexible Engagement Approach*, 27 July 1998), and enhanced interaction as the dividing line between domestic affairs and external or transnational issues has become less clear. "Many domestic affairs have obvious external or transnational dimensions, adversely affecting neighbors, the region and the region's relations with others." Besides the haze problem, the East Timor and Bank Bali scandals are cases in point.

ASEAN members will have to discuss these issues thoroughly to face them and find out the approaches to resolve them by formulating the measures into the *Treaty of Amity and Cooperation in Southeast Asia* to make it compatible with the new security issues with its challenges to independence, sovereignty, territorial integrity of Southeast Asian nations, with the challenge of non-interference in the internal affairs of one another. This is our challenge for the coming century. If such an attempt were to fail or seem to be insurmountable, then new, more comprehensive instruments will have to be designed. Only then will ASEAN regain its relevance and credibility and make the implementation of the ASEAN Vision 2020 a creditable agenda.

Review of Political Development



Bringing the Power Back to the People Reflections on the People's Consultative Assembly (1999-2004)*

Kusnanto Anggoro

THE fall of Soeharto has led to rapid changes in the map of political forces. Political pluralism has been established, geared towards democratic competition and representation. The people's representatives have now got the courage to express their opinions openly.

Nevertheless, the rules of the political game cannot accommodate the values of democracy. The legal foundation of political democracy as expressed in the five political affairs laws (the law on political parties, the law on general elections and the law on the structure and position of the MPR and the House of Representatives (DPR)) was decided by the New Order's DPR and is therefore considered in some quarters to be lacking in legitimacy. Moreover, the process developing prior to and during this MPR general session shows that the dominant political philosophy is to control access to the resources of the state's policies.

The structure of a democratic and just Indonesia seems to entail problems which are too big for the MPR alone. What has thus been going on is imperfect reform. The popular sovereignty has had to compromise with the sovereignty of the political elite. The morality, integrity and consistency of the people's representatives remain big problems.

Electoral Politics, Elite Maneuvering and the People's Sovereignty

The 1999 general election was the first democratic election in Indonesia in the past four decades. On the surface, there was a very strong spirit to bury the "Soehartocracy." However, the democracy to be found in the political institutions this spirit has brought about has not yet fully met the criteria and process of democracy. There are too many loopholes in the five political affairs laws.

Owing to the desire to minimize the effects of an uneven population spread, for

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example, the "value" of a representative in an electoral area differs from one to the other. Hesitation to apply the pure district voting system, which led to the final choice of an improved proportional system, has resulted in the fact that electoral areas outside Java have a larger denomination number of voters compared with electoral areas in Java. One of the results is that the National Awakening Party (PKB) has a smaller number of representatives than, for example, the United Development Party (PPP), despite the former's larger number of supporters.

More seriously though, is the number of Assembly members whose place is not determined through a democratic process, particularly the 38 members representing the Indonesian Military/TNI (5.4%) and the 65 representatives of the various interest groups (9.2%). The General Election Commission (KPU), most of whose members have an interest in electoral politics, has much more authority than it deserves. For example, it determines the number of social categories which may put forward interest group candidates. The principle of inclusion, one of the pillars of democracy, is not fully reflected in the members who represent social groups. As a result, representatives who are not elected through a democratic process may account for 40% of the total members in the MPR.

Of course, the transition to democracy is by nature a process. Perhaps a more democratic formula may be found in the future. Idealism must often compromise with political realities, especially in a transitional period. It may well be that for the present MPR the most thwarting thing is not their lack of competitiveness and representativeness. From the point of view of the morality of

democracy there is a more serious problem. Political compromises have again confirmed the oligarchic centralism of a party's power. In many cases, the central governing boards of parties play a more determining role than the parties' regional governing boards. The Jakarta-based elite, who are socially and culturally detached from regional issues, have joined the Assembly through the regional representative channel. For example, Ginanjar Kartasasmita (West Java) and Soebiyakto Tjakrawerdya (East Java). Therefore, the General Session of the MPR has become the final terminal for people's sovereignty.

It is this oligarchic power that has enabled the elite to conduct political maneuvers without accountability to their voters. It is also due to this maneuvering that the "axis force" is on a par with parties with larger electoral support, such as the Golkar Party and the Indonesian Democratic Party of Struggle (PDI Perjuangan). In other words, parties are as yet unable to fully play their role in a fair process to recruit their political leaders. The growing emergence of leaders from the regions, who, perhaps, enjoy wide political support and are deeply rooted in their local communities, simply has to be buried because of a short-term calculation. Members of the National Mandate Party (PAN) in Yogyakarta could not have imagined that Fuad Bawadzier, who was previously known as a Crescent Star Party (PBB) activist, would be their leader. Similarly, people voting for the Justice Party (PK) in the June election could not have imagined then that Abdurrahman Wahid would represent them as president. The phenomenon of the axis force is an indication that political maneuvering plays a more determining role than electoral powers.

According to the provision in Article 32 of Law No. 4/1999, the MPR is "the full holder of people's sovereignty." However, the delegation of people's sovereignty to their representatives at the DPR/MPR is not unconditional. This delegation is actually coupled with an obligation on the part of political parties to be accountable to their political constituents. Without such accountability, they will not have a moral basis on which they may consider themselves people's representatives. In other words, the maneuvers of the political elite and the centralism of a party's oligarchy have given rise to the problem of legitimacy.

During an election campaign period, a political party should not only nominate its presidential candidate but also tell the people with whom the party will establish an alliance if it fails to win the majority. Undoubtedly, direct presidential election is the most democratic and legitimate way to elect a president. As long as this is not possible to implement, legitimacy may be obtained from a recognition that the party enjoying the biggest support in the election should be authorized to form a government.

Alliance Predictability, Regime Support, and Governability

The general election held in June 1999 failed to produce a dominant power in the MPR. Alliances, coalitions or other forms of political cooperation which have developed since then are not based on ideological considerations or party programs. Contemporary issues and short-term calculations to block political foes play a more determining role. Consciously or not, the temptations of power and money are still too large. Even a sus-

picion that money politics is being practiced is in itself indirect evidence that the institutions of control and suspicion are still strong. One thing is certain: Political institutions, including political parties are created for achieving power and not for fighting for political morality and channeling aspirations. Political trust, which is an important element in democracy, is still a rarity.

There are many factors to examine in this respect. Self actualization seems still to be a serious problem for political parties. The mission of a party, particularly regarding how it will place itself in the relationship between the people and the state's power is similarly problematic. The traditional functions of a political party are of great importance. Not a single party has expressly stated one of their modern functions, to manage social and political conflicts. Political parties still place a greater emphasis on articulation rather than on the aggregate of interests. Mottoes about democracy, justice, good governance and transparency are found in the manifestoes of almost every political party. However, not many of these parties have specifically formulated a strategy on how to achieve these hopes. Most parties support the redistribution of economic and political assets, but this kind of empowerment and affirmative action has been explicitly stated by only a few parties, among others, the People's Sovereignty Party (PDR) and PAN. Party actualization to represent popular interests seems to be merely political jargon.

Shortsightedness is another weakness. It is not easy to distinguish the platform of one party from another. Only a few political parties have issued in great detail the political agenda of the parties. All parties reject

the *status quo*, and would like to see the democratization of the relationship between central and regional governments, as well as between the people and the state.

In several respects, it is not immediately clear how to bridge the gap between "impairing the state's sovereignty" and that of "reinforcing the people's sovereignty". Short-term programs with the aim of rescuing the country from the (economic) crisis, for example, can only be found in the programs of, among others, the Functional Group, PDI-P, the People's Democratic Party (PRD) and the Republic Party. From the social point of view, the jargon used is to build "the life of more cohesive social institutions characterized with tolerance and mutual respect." However, in a number of discussions, the demand for being proportional is more prominent than that for tolerance. In international affairs, no parties have rejected Indonesia's involvement in the global economy, although some of them have laid more emphasis than others on the significance of preparing to face it.

It is very likely that these two things stem from an unfinished process of stripping away at ideology. Pancasila is still recognized as a principle for most political parties, including PKB, the National Mandate Party (PAN), PDI Perjuangan and the Golkar party. Other parties have faith in Islam as a principle, for example, the Indonesian Islamic Unity Party (PSII '05), Masyumi, New Masyumi, the United Development Party (PPP), the Islamic Community Party, the Crescent Star Party, the Justice Party, the Muslim Awakening Party (KAMI), the Democratic Islamic Party and the United Party. Marhaenism is the principle of PNI-Masa Marhaen (the Indonesian Nationalist Party - Mar-

haenist Masses) while socialist democracy is the principle of the Democratic People's Party (PRD), the National Labor Party (PBN) and the Murba Party. Although maintaining the principle of Pancasila, a number of parties also clearly state principle such as nationalism (PKB, PDI Perjuangan) and religious morality (PAN, the Indonesian Democratic Union Party/PUDI). The absence of open political and/or ideological debate for almost four decades seem to have given birth to an extraordinary counterculture. Yet this counterculture has yet to find its form in a political mission or program-based plan of action.

In view of the above picture, it is not easy to imagine a program-based alliance or coalition, something which is actually important to judge the character of policies and debates in the representative institutions or in the relationship between the legislature and the government. It may well be that the elected DPR will become an arena for debates which will help it as a legislation-making body and an institution balancing the power of the president. An alliance, or coalition, in this institution will only be in effect on an ad hoc basis. At the same time, the president (elect) is very likely to be confronted with a serious problem. His or her regime's support and ability to govern will be very low. It is very likely that the administration resulting from the 1999 General Session of the MPR will be very dependent on decrees or regulations in lieu of laws, presidential decrees (and instructions) as well as other regulations with less democratic accountability.

To avoid this, the president elect must compose a cabinet of national reconciliation, in which there will be no compromise between power sharing and meritocracy. It is

highly likely that the new regime will be no more than a transitional regime with a limited mandate, and it will therefore only attend to the most pressing problems, particularly economic recovery, social order and political stability. As it is quite possible that the new administration will not be able to complete its tenure (1999 - 2004), issues about the Popular Committee, Triumvirate and various other extra-constitutional choices will continue to be discussed for a few months after the establishment of a new administration.

Safe Exit and the Agenda for Reforms

Indonesia has always faced a prolonged political transition. The crisis of legitimacy and constitution marked not only the transition from the Old Order to the New Order, but also from the New Order to the Reform Order. Politicians seem to be shortsighted in their attitude and refuse to learn from past mistakes. Almost all institutional structures, particularly legislation and the legal foundation of the process of democratization itself, have serious inherent weakness. Ideas to find an alternative for and formulate a "safe exit" from the past, therefore, become a necessity. Prolonged debates about the composition of the leadership of the DPR-MPR, inefficiency and the initial sessions of the MPR when the Assembly is still chaired by the oldest and the youngest members reflect a shortsightedness in drawing up the regulations. In future, the initial sessions perhaps should not be chaired by the oldest and the youngest members, but by the leaders of minor parties represented in the DPR and the MPR. In this way egalitarianism, which is an important principle in democracy, will be set forth.

The formulation of legislation must also allow contingency plans. According to the

provisions in the laws on political affairs, for example, a member of the MPR/DPR "shall assume his position for five years, and shall give it up when a new member is sworn in. The general election is held once every five years." Actually these formulations are relaxed to that they will read, for example, a member "shall assume his position for five years unless the general election is moved forward," and "the general election is held once in five years, unless it is moved forward." The next subarticles will regulate how an election can be moved forward, for example if there is a crisis of confidence in the government. Besides, amid the likelihood of secret ballot, the factions at the DPR/MPR become no longer relevant. A safe exit like this is also politically acceptable to a triumvirate, particularly if political dealing or horse trading causes the triumvirate to fall under the control of a particular political power.

The illustration above shows that there are too many items on the agenda that will be discussed in the session of the MPR/DPR (1999-2004). The ad hoc committees of the MPR are now discussing the broad lines of the state's course (GBHN) (Ad Hoc Committee I). Amendment to the Constitution is being discussed in Ad Hoc Committee II and the non-GBHN materials are being dealt with by the Ad Hoc Committee III. Items of prominence in Ad Hoc Committee I are, among others, the spirit of people's economy and economic nationalism. The Ad Hoc Committee II is formulating the re-arrangement of the relationships among the state's high institutions, including the limitation of the power of the president and the accountability of the state's institutions to the state's highest institution (the MPR). The president's powers will be very much reduced, for example in conferring medals of honor, in

drawing up a Cabinet, in installing envoys and consuls, and granting amnesty, abolition and clemency. The Ad Hoc Commission III is busy, particularly with the procedure for presidential nominations and elections. It has now been agreed that someone, from inside or outside a legislative institution, may be nominated president if he or she is supported by a minimum of 10 percent of the members of the MPR. The presidential election will be executed in stages with the final round limited to two or three candidates.

It is not clear whether the formulation of GBHN like this is a natural movement following the necessity generated by the movement of the pendulum from one extreme (the New Order) to another (the Reform Order), or whether it is really based on rational calculation, for example the preparedness of the bureaucracy and the support of the international community. In the Ad Hoc Committee II, all factions seem to agree on the form of a unitary state and the presidential administration. One thing which may be discussed again is the devolution of power, including the idea of federalism and/or parliamentarianism, which in the last two years have been widely talked about. Debates are continuing on the future of a number of the state's high institutions, particularly with regard to the Supreme Advisory Council (DPA) and the Supreme Audit Agency (BPK). It is yet to be agreed whether the election of a new president will eventually be carried out through voting or deliberation for a consensus. Also, it is not clear whether the voting victory will be determined by a simple majority or a single majority (50 percent + one). It is also yet to be discussed to whom the president will have to present his accountability report.

All democracies have uncertainty about who will be elected for a key position and what he or she will be doing. However, this uncertainty in a democratic process is not cast in stone. The spirit of the majority to obtain a constitutional guarantee is like the guarantee of protection for the minority. In democracy there must be regulations that are agreed upon, although they may not be in black and white. For example, those enjoying the support of the majority of votes in a ballot will be authorized to control the administration, although at the same time they are obligated to protect and give an opportunity to the party enjoying less support. Democracy needs not only legality but also legitimacy. It is hardly possible to create democracy by resorting to authoritarian methods.

The General Session of the MPR may be a threshold event but it will not automatically pave the way for democratic government. Experiences of democratic transition in a number of countries show that although reinforced by constitutional reform, presidentialism will always create a system in which the executive party will be able to successfully confirm its supremacy over the branches of the legislative power. Thanks to its control of the economic access to economic resources, budget determination for example, the executive party can sometimes even politicize and intimidate the judiciary power. The power of an organizational basis, particularly the bureaucracy of the administration which regulates the day-to-day life has led to the executive power, in a presidential system, always having the upper hand over the legislative power, and therefore, the people. Representative and responsive politics require not only democratization

but also political accountability -- horizontally among the state's institutions (read: check and balances) as well as vertical accountability between the people and the parties as well as political representatives.

Conclusions

According to Samuel Huntington, long term democracy "may depend less on these easily identifiable moments of decision than on the painstaking construction and quotidian care of democratic political institutions, practices and culture". Indonesia is facing the challenge of needing to conduct "de-Soehartocratization" and discover a new ethos of democracy. Political representation and political pluralism are only a small part of a long process of the manifestation of the people's sovereignty. It is almost certain

that the forces to translate these desires into reality do not lie in the formal political process, such as seen in the structure of the DPR/MPR. The people's participation will not end with the casting of a vote. A combination of fragile coalitions, alliances and/or associations among parties in the House, the limitation of party programs and the need for the rearrangement of the next general election will make post-election politics difficult. It will reinforce the urgency of the dynamics of *quatropolitics*, namely the constructive interaction among members of political, society, the civil society, the professional society and the moral society. Mass movements and various other forms of moral movements will continue to play a significant role in influencing public discourses and political agendas.

Post Election Politics and Indonesia's New Regime of Reformation

Ign. Ismanto & T.A. Legowo

THE October 1999 General Session of the People's Consultative Assembly (MPR) finally elected K.H. Abdurrahman Wahid (Gus Dur) and Megawati Soekarnoputri (Mega) as the President and Vice President of Indonesia respectively for the 1999-2004 period. No single political party held the majority of popular vote resulting from the election that subsequently brought about uncertainties concerning the

contest of presidency. The elite's political maneuverings in the post-election tended to ignore the factual result of the election in which the winning political party of the elections with plurality votes might not be able to win the presidential contest in the MPR. This was basically the very challenge to the democratic consolidation in Indonesia. The deteriorating condition of Indonesia's politics and economy reflected among

others in Bank Bali scandal, post-referendum problems of East Timor, and the acknowledgment of the controversial law on national security posed another serious challenge to the process of democratic consolidation. However, many expected that the new leadership of Gus Dur and Mega could really cope with the current problems to maintain political stability, to lead the process of democratic consolidation, and to recover Indonesia's economy.

Post-Election Politics

It was only reasonable that in the turbulence time of economic and political crises people expected a general election which might result in the formation of a new legitimate and credible government. This was believed as the very pre-condition for Indonesia to get out from the crises that had occurred since the mid 1997. And the most related issue of the election was the competition for presidential candidacy. Prior to the election, Golkar Party had already nominated the incumbent President B.J. Habibie as its sole presidential candidate. National Mandate Party (PAN) came out with the nomination of Dr. Amien Rais. Crescent-Star Party (PBB) nominated Dr. Yusril Ihza Mahendra. Meanwhile, Indonesia Democratic Party of Struggle (PDI-P) proposed its General Chairperson, Megawati Soekarnoputri, as its presidential candidate. Megawati was also supported by National Awakening Party (PKB).

Presidential nomination by political parties prior to the election was basically a new phenomenon in Indonesian politics. But, it was widely accepted as it would avoid the po-

litical practice of "buying a cat in the sack".¹ Indeed, the actual grounds of this phenomenon was the emphasis of the important relation between the general election and the presidential election. However, this is something that is not suitable with the current electoral system and structure.

First, the electoral system constructs merely elections for members of parliament at national as well as local levels. Presidential election is constitutionally pursued through indirect election conducted by the MPR. This was the main reason why 34 per cent of the popular votes of the winning PDI-P was not a guarantee for the party to win the presidential election in the MPR forum in which the party held 158 out of 700 seats in the MPR. *Second*, the structural obstacle resulting from the structure and the membership composition of the MPR are not based upon and conducted through general elections.² These obstacles undermined the rationale of political practice as mentioned above. These obstacles did not prevent the public to expect that the new and fresh MPR might consider seriously the real fact of the election results.³

The post-election politics was characterized by the increasing competition of presidential candidacy which was growingly polarized into two political blocs between Megawati and Habibie. Primordial symbols contributed to sharpen the political polarization. A number of ulemas from the Indonesia's

²Member of the MPR that are not recruited from the general election are TNI (38) and Group representatives (65). Regional representatives are elected by provincial parliaments (DPRD I) whose membership are elected through the general election.

³*Kompas*, 2 October 1999, and *Suara Pembauran*, 8 October 1999.

¹*The Jakarta Post*, 21 May 1999.

Ulema Assembly (MUI), supported by sixteen Islamic organizations, openly supported Habibie's candidacy, and at the same time, refused woman presidential candidate. This had developed into "political labeling" that dichotomized Habibie's bloc as representing "Islamic power" and Megawati's bloc as representing "secular-nationalist power". Of course, this dichotomic political labeling was in fact invalidated given the fact that, *first*, the majority support for Megawati in the election came from Islamic voters, and *second*, Megawati candidacy was endorsed too by PKB, an Islamic based political party.

The emergence of "Central Axis", initiated by Amien Rais of PAN, was very much derived from Rais' evaluation that the sharpening competition between Habibie's and Megawati's blocs might endanger the integration of the nation, and that the nation needed to have an "alternative force" being able to keep the unity of it. Apart from this normative reasoning, however, the absence of a dominant political party resulting from the election had led Amien to think about parties' coalition in order to form a majority power in the MPR. Central Axis, therefore, composed several political parties. It was also the fact that the idea to form Central Axis was inspired by the plan of a number of Islamic parties to form an Islamic fraction in the Parliament.⁴ Central Axis nominated Gus Dur as its presidential candidate. This nomination was of significance considering Gus Dur as the leader of the biggest Islamic organization, Nahdlatul Ulama, whose members were no less than 40 millions. To some analysts, however, the formation of Central Axis was seen as a political struggle to re-

establishing the legitimacy of President Habibie.⁵

Mobilizing political support for presidential candidacy by political parties was a normal political process. For the case of Indonesia, however, the question was as to how far this political competition persuade the increasing quality of political education and democracy. This combined with the factual challenge of resolving current political-economy crises would be real formidable tasks for the Indonesia's political elite. The very pluralistic character of Indonesian society in terms of ethnic, religious, language, and race should not be seen as obstacles to democratization process. The most serious obstacle for democracy to prevail in Indonesia in the current turbulence time of political-economy crises was the problem of absolute poverty and unemployment that had marginalized and violated human values and dignity as shown in the case of Aceh, East Timor and Ambon. This actually resulted from the authoritarian and monolithic political system that eventually had weakened Indonesia's justice system as well as transparency and accountability of the government. The 1999 October General Session of the MPR was therefore expected not only to become a fair arena for elite's power circulation but also facilitate real changes of the authoritarian and monolith economic and political system.

The October General Session of the MPR and the Amendment of the 1945 Constitution

The 1999 general session of the MPR occurred in a spirit of democracy and reflects

⁴*Suara Karya*, 21 July 1999.

⁵*Suara Karya*, 21 July 1999.

the nuance of accountability aspects. The process of presidential election, which was part of the agenda session of the MPR, also presented a new conjuncture for the development of democratic culture in Indonesia. Furthermore, the general session has resulted in a number of substantial changes in the setting of Indonesia's political system. In many aspects, the October general session of the MPR differed substantively to the past MPR's general sessions.

For the first time in the history of the MPR, the October session decided to introduce voting mechanism for the Assembly's decision making process. Deliberating issues during the session such as internal regulations of MPR, election processes of MPR's as well as DPR's speakers, accountability speech of the incumbent President, and election processes of President and Vice President, were decided through voting mechanism. This was absent in the past. But, the question remains whether or not the MPR's voting mechanism is able to increase the quality of MPR's accountability, and to promote transparency at all institutional levels of decision making processes.

The October general session also changed the status of political parties' fractions in the MPR. In the past, parties' fractions stood as parties' representatives in the MPR and their policy views must reflect their respective political parties. A discenting view by member of the fractions may result in recalling their representative from the MPR. The current practices of the MPR blow fresh air in the sense that fractions now stand as political groupings which are relatively autonomous from parties' involvement.

For the first time the MPR also initiated policy that allowed competition on presiden-

tial candidacy in which each fraction could propose its own presidential candidate. This had subsequently brought about changes on the mechanism of presidential election from one that was based on "deliberation for consensus" to the one that was based on voting. With these new arrangements, the MPR became a real arena for fractions' as well as individual competition for power. This was also absent in the past. For six times of MPR's general sessions in the New Order era, there was only a sole presidential candidate who happened to be always the same person, i.e. President Soeharto.

It is also worth noting that all plenary sessions of the MPR were open to public. This was significant for accountability aspects of the Assembly as well as for political education. The public could follow and watch what was really going on during the MPR sessions, and eventually evaluate whether or not the MPR was really working for their interests and aspirations, and whether or not democracy had prevailed in all decision making processes in the Assembly.

With all these new arrangements, the October general session of the MPR has resulted in a number of substantial basic state policies that may guide Indonesia to follow the course of democratization. The most progressive decision of the MPR was the First Amendment of the 1945 Constitution of the Republic of Indonesia. Nine of the 37 articles of the Constitutions were amended. (See Appendix 1 for details) The amendment not only ended the dominating power and role of the President (the executive) over the DPR (the legislature), but also broke up public psychological barriers to reform the 1945 Constitution. The former may result in the

change of the structure of government from the character of executive that is more dominant to that of equal balance between the executive and the legislature in which the mechanism of checks and balances could function properly. The latter may provide favorable condition for the continuation process of constitutional reform in ways that develop the 1945 Constitution on the basis of democratic principles in order to be able to form a democratic political system in Indonesia.

The First Amendment of the Constitution, however, was seen as still being a partial constitutional reform. Criticism said that to have a comprehensive democratic reform of the 1945 Constitution, further steps need to be systematically conducted. Responding to this demand, the general session of the MPR issued another MPR Decree (No. IX/1999) on the Establishment of MPR's Ad hoc Committee for Constitutional Reform. The Committee is given twelve months time to complete its task to formulate a comprehensive reform of the 1945 Constitution.

The 1999-2004 Broad Outline of State Policy (GBHN) is another decision of the MPR that accommodates a number of public demands for economic as well as political reform. In the economic field, GBHN provides the new government with directive foundations to develop free market economy on the basis of fair competition and limited role of the state, to take concrete efforts to recover the economic crisis, especially in restructuring the banking system, and to acquire a system of social security to guarantee the proper life of the society.

In the political field, GBHN stipulates four basic policies. The *first* deals with the

necessity of national reconciliation. This is very relevant to the current development of Indonesia in which it is marred by not only primordial social and political conflicts but also regional upheavals that may potentially bring Indonesia into social and political disintegration. The *second* basic policy stressed on the need to endure the process of democratization. This includes policy directions to develop a democratic political system in ways that guarantee the mechanism of checks and balances to function well, to increase the quality of general elections based on transparency, free and fair principles, and to carry on systematic efforts for implementing the gradual withdrawal of TNI from political roles.

The *third* one concerns with the creation of clean and accountable government. This includes policy directions to eradicate KKN (corruption, collusion and nepotism) practices in the government, to promote professionalism in the bureaucracy, to increase the social-economic welfare of civil servants, and to maintain the neutrality of civil servants from party politics. And, *fourth* is the policy program of decentralization and regional autonomy. This policy is directed basically to develop regional and local capabilities by transferring administrative, economic and political authority from the central government to regional and local governments.

Elections of President and Vice President

Through a closed-voting mechanism, the MPR elected Amien Rais as the new MPR's speaker. The selection of Amien Rais was politically significant for several reasons. *First*, it was seen as the result of Central Axis solidity that might increase Habibie's chance

to win the presidency. Rais' selection was impossible without Golkar's all out support. In return, Golkar might have similar support from Central Axis in nominating Habibie's candidacy.

Second, Rais' selection provided bigger chance for Gus Dur to be elected as president. There were two reasons for this possibility, namely the commitment of Central Axis to nominate Gus Dur as presidential candidate, and the split of into to political camps: i.e., Habibie's supporter and non-supporter camp on the issue of presidential nomination. Gus Dur nomination might get support from the Habibie's non-supportive of Golkar. Both Amien Rais and Gus Dur had strong commitment not to support Habibie's presidency because of Habibie failed to manage Indonesia's economic and political problems. *Third*, the solidity of Central Axis reflected in its capability to mobilize support for Amien Rais might weaken the support for Megawati's candidacy in ways that PKB might split in supporting her.

All these possible power compositions in the MPR might undermine the strong public image (or hope) that Megawati as the presidential candidate of the winning political party in the general election would be guaranteed to be the new elected president. This tendency actually indicated two

things. *First*, Megawati's camp in the MPR should immediately consolidate itself in order to be able to mobilize support for Megawati. This would mean that the camp should expose itself for the possibility of forming a grand coalition with other fractions in the MPR. *Second*, Central Axis coalition could not be taken for granted as an effective political power in directing the process of presidential election. The campaign of "any body but Mega" for the presidency seemed to be effective in fragmenting the support for Megawati. The first, if succeeded, might result in a power composition of the MPR dominated by PDI-P coalition. The second would imply that whoever the candidate was, if supported by Central Axis, he/she had a greater chance to be the new elected president. This could be Habibie or Gus Dur.

It was very unfortunate that Habibie withdrew his presidential candidacy following the MPR's refusal to his accountability speech.⁶ And the withdrawal of Yusril Ihza Mahendra of PBB from the candidacy a minute after the presidential election process started caused the competition for presidency being concentrated on the competition between the Central Axis and the PDI-P camps. But, no body was sure who was going to be selected president. Nevertheless, Gus Dur have a greater chance than Megawati to win the election. He was more accept-

⁶At least there were two opposing arguments concerning this issue. It was argued that there is no legal basis that relates accountable speech of the president to the process of presidential election. No laws regulate that an incumbent president whose his/her accountable speech is refused by the MPR could not run for the next presidency nomination. This argument was supported by, among others, Prof. Harun al Rasyid (*Suara Karya*, 20 October 1999), Prof. Ismail Sunny (*Suara Karya*, 16 October), and Dr. Jimly Assiddiqic (*Republika*, 19 October 1999). The opposing

argument, based upon ethics and legitimacy reasons convinced that although there is no law and regulation concerning the issue, it is very illegitimate for a "failure" president to run for the next presidency. It is up to the person him/herself to decide based on his/her knowledge on the ethic of democracy. This was supported by, among others, Amien Rais (*Kompas*, 16 October 1999), Khofifah Indar Parawansa (*Merdeka*, 18 October 1999), and Siswono Yudohusodo (*Suara Pembaruan*, 19 October 1999).

able to almost all segments of the MPR's fractions. After all, Gus Dur is a moderate-nationalist Moslem. Megawati was certainly acceptable to nationalist and some Moslem segments of the MPR's fractions. But, there was a strong hold amongst other Moslem segments of the MPR's fractions as well as that of the society in general to refuse woman leadership, a political issue that invited public debate, even among the Moslem community.

The presidential election finally resulted in the selection of Gus Dur as the new President of Indonesia with the following composition of votes: Gus Dur 373, Mega 313, abstain 5, and absent 4. Since it was conducted through a closed-voting mechanism, it was rather difficult to identify how votes for this election were distributed. Seemingly, the election reflected much more the contest of political symbols between political Islam and nationalist rather than that of personality between Gus Dur and Mega. The likely votes' distribution below emphasized that reflection. To some segments of Moslem communities, the selection of Gus Dur was acclaimed loudly. But to some segments of Megawati supporters, it was a disappointment of the nationalist bloc. It was unthinkable for them to realize that the leader of the winning political party in the general election could be decontested in the presidential election. This also explained the cause of some violent reactions in several regions following the defeat of Megawati.

Following the presidential election was the election of Vice President, which was no less dynamic from the former. Prior to the voting process, there were at least four vice presidential candidates. Megawati was nominated by PKB; Akbar Tanjung by Golkar;

Hamzah Has by PPP; and Gen. Wiranto by PDU and a significant number (70) of MPR's members from several fractions. The interesting point was the fact that PDI-P did not nominate Megawati. The reason was simply not because the party did not want Mega to hold the vice-presidency, but it tried to drive the selection of Mega on the deliberation basis. There was strong indication that the majority of the MPR could accept Mega as the Vice President. If this is the case, voting for the vice presidency was no longer necessary. The road to this drive was very close when Akbar Tanjung and Gen. Wiranto withdrew their nomination a minute before the voting process. But, the challenge came from Hamzah Haz who maintained his nomination by arguing that it was the party's mandate that he could not reject. And, it seemed that PKB was taking over the responsibility to win Megawati's vice-presidency against Hamzah Haz' challenge. The final result of the election that won Megawati with perfect votes was seen as the success of PKB in mobilizing support for Mega's vice-presidency.

Both presidential and vice presidential elections were transparent and conducted through a democratic process. It does not mean, however, that the process of presidential elections left no problems at all. One of them is that there was no significant implication of the general election to the presidential election. This might implicate to building public image that general elections were practically useless and meaningless. Another problem was that elite's fragmentation in the MPR might have significant effect on the political fragmentation in the society, which in turn would not be conducive for democratic consolidation.

THE LIKELY VOTES' DISTRIBUTION FOR THE PRESIDENTIAL ELECTION

Fraction	MPR Membership			Votes for	
	DPR	Reg. Reps.	Total	Gus Dur	Mega
PPP	58	12	70	70	-
PDU (small Islamic parties)	9	-	9	9	-
KKI (small nationalist parties)	12	2	14		14
PKKB	5	-	5		5
Groups Reps.	-	(65+) 8	73	45	28
PKB	51	6	57	35	27
Golkar	120	62	181	144	37
Reformasi (PAN & PK)	41	8	49	49	-
PDI-P	153	32	185		185
TNI/Polri	38	-	38	8	30
PBB	13	-	13	13	-
Total	500	195	695	373	313

Note: (65+) are groups representatives of the MPR.

Sources: elaborated from several sources.

The Cabinet of "National Unity"

The so called "National Unity Cabinet" formed by Gus Dur accommodated all major political groups and various societal segments in the country. Such a cabinet seems to bear several consequences. *First*, it had to be a large cabinet. In fact, the Cabinet consists of 35 ministries, much larger than it was planned. This would of course caused inefficiency. There are a decision to set up one new department (the Department of Maritime Exploration) and three state ministers, namely state minister for regional autonomy; state minister for social affairs and state minister for settlement and territorial development. The Department of Information and the Department of Social were closed down.

Second, it had to accept much more socio-political rather than professionalism considerations in the appointment of Cabinet's personnel (ministers). As Gus Dur himself admitted that the formation of the Cabinet was basically resulted from the consultation

with four political leaders: Megawati, Amien Rais, Akbar Tanjung and Gen. Wiranto. They supplied Gus Dur with candidates, some of which were included in the Cabinet. Gus Dur considered these ministers as being guaranteed by their patrons and expected them to share the responsibility for their inclusion. Only some members of the cabinet that came from within the bureaucracy had been selected primary on the basis of their professional experience.

Third, it might have lack of coordination, simply because the ministers have a variety of political background, interest and constituency. This might cause the problem of responsibility, as to whom primarily the ministers must give their responsibility: to the President first, or to their parties' constituency.

The new government will face at least three main tasks. *First*, to sustain the process of political reform and implement the decree of MPR's general session. *Second*, to prevent Indonesia from social and political disintegration and to rebuild the social

trust between individuals as well as social groups of the Indonesian society. *Third*, to solve the long-standing economic crisis and its social impacts, and to solve comprehensively the case of Soeharto and other cases of KKN (corruption, collusion and nepotism).

Concluding Notes

The emergence of new government in Indonesia under President Wahid and Vice President Megawati has ended the initial phase of political reform in Indonesia. The 1999 General Election, took place relatively fair and democratic so was the formation of the DPR and the MPR. The October general session of the MPR occurred democratically and transparently. The process of presidential election, also presented a new conjuncture for the development of democratic culture in Indonesia. Furthermore, the general session of the MPR has resulted in a number of substantial changes in the setting of Indonesia's political system. Indeed, this initial phase of reform has produced a "new regime of reformation" in Indonesia. It remains to be seen, however, whether this new regime could lead the process of economic as well as political recovery that can bring about prosperity and democracy in Indonesia in the years ahead.

Appendix

The Amended Articles of the 1945 Constitution

- Article 5
 - sub-article 1: "President has the right to propose bills to the DPR".
- Article 7: "President and Vice President hold office for five years term, and can be reelected for the same positions for one more term only".
- Article 9: on the oath of President (Vice President).
- Article 13
 - sub-article 2: "In appointing ambassadors, President takes the DPR's considerations into account";
 - sub-article 3: "President accepts the designation of other countries' ambassadors by taking the DPR's considerations into account".
- Article 14
 - sub-article 1: "President confers rehabilitation and clemency by taking the Supreme Court considerations into account";
 - sub-article 2: "President confers amnesty and abolition by taking the DPR considerations into account".
- Article 15: "President confers awards, merits, and other honorary titles based on legislation".
- Article 17:
 - sub-article 2: "Ministers are appointed and dismissed by President";
 - sub-article 3: "Each minister works on a certain field in the government".
- Article 20
 - sub-article 1: "The DPR has the power to form laws" (*legislative power*)
 - sub-article 2: "Every bill is deliberated by the DPR and President to get a join approval";
 - sub-article 3: "If a bill does not get the join approval, the bill cannot be repropose at the same period of deliberation";
 - sub-article 4: "President formally signs the bill that has got the join approval to becomes law".
- Article 21: "Members of the DPR have the right to propose bills".

Governance, Civil Society, and Democracy*

Carolina G. Hernandez

Introduction

THE issue of governance, especially good governance arose following the end of the Cold War some ten years ago. Fortified by the implosion of the Soviet Union that symbolized both totalitarian political rule and a centrally planned economy, democratic and market-oriented societies prided themselves in the correctness of their political and economic systems of governance. The triumph of liberal democracy and the market led to a general feeling of elation in the West and inspired intellectual articulation of this "truth" as exemplified in Francis Fukuyama's internationally acclaimed *The End of History and the Last Man*.

Advanced industrialized countries organized in the Organization for Economic Cooperation and Development (OECD), similarly inspired by this sense of triumphalism adopted in its July 1991 summit in London a development aid policy linking ODA and good governance. Among the components of good governance are human rights observance and democracy, market reforms, bur-

eaucratic reform (anti-corruption and transparency), environmental protection and sustainable development, reduction in military and defense expenditures, and non-production of weapons of mass destruction.

It is obvious that ODA would now seek domestic political, social, and economic reforms to promote democracy and the market, as elements of good governance in the recipients. Even Japan that had been the most conscious of the sensitivities of developing countries about national sovereignty and independence and their allergy to linking ODA to domestic political and social reforms had to come up with its own ODA Charter.

The Asian financial crisis also highlighted the negative consequences of bad governance in both the public and private sectors. Lack of transparency and lack of accountability by those who govern that seem to be easier facilitated by authoritarian compared to democratic systems of governance and by controlled economies were identified as one of the main causes of the crisis. This became the context for increased clamor for better governance in the public and private sectors, and in civil society as well as guarantees for a stable, responsive, and effective polity, a healthy economy, and a responsible civil society.

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It is in this context that this paper seeks to articulate the issues behind the theme: Governance, Civil Society, and Democracy. The discussion will be limited to political governance in the public sector, including the role of civil society in democratic governance. It will first try to define how these three concepts are to be used in the paper before discussing the experience of the Philippines in dealing with these issues in its march from authoritarianism and bad governance to democracy and better governance and how civil society is seen as a critical component of good governance and democracy.

The Meanings of Governance, Civil Society, and Democracy

Simply put, governance refers to the way in which organizations, whether in the form of the family, the community, the civil society, corporations, the state, or regional and global organizations are run or managed. Governance involves a set of principles and rules defining the organizational structures and the responsibilities, accountabilities, functions, entitlements, and powers of those who govern and are governed in an organization. It includes the processes by which decisions affecting the organization are made.

In general, governance can be good or bad: good when collective goals are served well, the processes of decision making are observed, governors perform their functions and exercise their powers properly, and the organization is sustained. It is bad when only the goals of a few, especially the governors are served, prescribed processes are breached, power and entitlements are abused, and when the organization's survival is

threatened or the organization fragments or dies. Thus, transparency and accountability on the part of those who govern are key elements of good governance as they ensure that the interest of the wider membership is served and because of this, their support for the organization remains ensuring there by its sustainability and survival.

More specifically, good governance, as defined by the United Nations Development Programme (UNDP) includes the following characteristics:¹

- Participation -- All men and women should have a voice in decision making, either directly or through legitimate intermediate institutions that represent their interests. Such broad participation is built on freedom of association and speech, as well as capacities to participate constructively.
- Rule of law -- Legal frameworks should be fair and enforced impartially, particularly the laws on human rights.
- Transparency -- Transparency is built on the free flow of information. Processes, institutions, and information are directly accessible to those concerned with them, and enough information is provided to understand and monitor them.
- Responsiveness -- Institutions and processes try to serve all stakeholders.
- Consensus orientation -- Good governance mediates differing interests to reach

¹As cited in Anggito Abimanyu, "Change Toward Good Governance and Anti-Corruption: The Case of Indonesia," a paper presented at the Second Intellectual Dialogue on Building Asia's Tomorrow: Promoting Sustainable Development and Human Security jointly organized by the Institute of Southeast Asian Studies and Japan Center for Intellectual Exchange, Singapore, 12-13 July 1999, 2.

a broad consensus on what is in the best interests of the group and, where possible, on policies and procedures.

- Equity -- All men and women have opportunities to improve or maintain their well being.
- Effectiveness and efficiency -- Processes and institutions produce results that meet needs while making the best use of resources.
- Accountability -- Decision makers in government, the private sector, and civil society organizations are accountable to the public, as well as to institutional stakeholders. This accountability differs depending on the organization and whether the decision is internal or external to the organization.
- Strategic vision -- Leaders and the public have a broad and long term perspective on good governance and human development, along with a sense of what is needed for such development. There is also an understanding of the historical, cultural, and social complexities in which that perspective is grounded.

Many of these characteristics are the same or similar to the political properties of democracy as will be discussed below. They include participation, rule of law, equity, transparency, and accountability.

Civil society, on the other hand, is usually defined as society's politically active popular sector² the domain that lies between the family and the state. It is "voluntary and self-generating", and while it seeks benefits,

policy changes, and accountability from the state, civil society "does not seek to gain formal power or overthrow the state".³ In short, it is "the voluntary, rule-abiding, politically active sector of society, autonomous from the state [encompassing] masses of citizens engaged in public protest, social movements, and NGOs acting in the public sphere [but] excludes the household, profit-making enterprises, political parties, and groups striving to gain control of the state through armed rebellion."⁴

Democracy is a highly contested concept, not only with regard to its superiority over other systems of governance, but also in terms of its meaning. According to Diamond, "[s]o serious is the conceptual disarray that more than 550 subtypes of democracy were identified in David Collier and Steven Levitsky's review of some 150 (mostly recent) studies."⁵ The definitions of democracy range from the minimalist that limits the range of its political properties to the maximalist that expands its political properties. Minimalists generally emphasize competitive elections for effective power. Among them are Schumpeter and Huntington. The former defined democracy as a system "for arriving at political decisions in which individuals acquire the power to decide by

³G. Sidney Sullivan and Lela Garner Noble, editors, *Organizing for Democracy* (Quezon City: Ateneo de Manila University Press, 1998), "Introduction", 13.

⁴Ibid.

⁵Larry Diamond, *Developing Democracy Toward Consolidation* (Baltimore: Johns Hopkins University Press, 1999), 7. He was referring to the two authors' "Democracy with Adjectives: Conceptual Innovation in Comparative Research," *World Politics* 49, no. 3 (1977): 430-451.

²Isagani R. Serrano, *On Civil Society* (Quezon City: Philippine rural Reconstruction Movement, 1993), 34.

means of a competitive struggle for the people's vote."⁶ In a similar vein, Huntington also emphasized competitive elections as the essence of democracy.⁷

Dahl's concept of polyarchy goes beyond this minimalist view in the sense that it looks at democracy as consisting of two dimensions: (1) opposition or organized contestation through regular, free, and fair elections, and (2) participation or the right of nearly all adults to vote and run for public office.⁸ However, Diamond argues that embedded in these two dimensions is a third that gives meaning to the first two. This third is civil liberty. In this context, polyarchy then "encompasses not only freedom to vote and contest for office but also freedom to speak and publish dissenting views, freedom to form and join associations, and alternative sources of information".⁹

This notion is also reflected in Scalapino's interpretation of democracy that recognizes its various forms in various historical, cultural, and other contexts. He defines democracy as a system of political governance in which citizens enjoy genuine political choice together with requisite rights to make this choice meaningful and rule of law.¹⁰ Such a definition allows a wide div-

ersity in the shape or form that democracy takes in various locations.

Liberal democracy on the other hand requires more than these minimalist criteria. It requires the following components:¹¹

1. Control of the state and its key decisions and allocations lies with elected officials rather than undemocratically unaccountable domestic actors or foreign powers; the military in particular is subordinate to the elected civilian political authorities;
2. Executive power is constrained both through the constitution and in fact by the autonomous power of other government institutions such as the legislature, an independent judiciary, and other mechanisms of co-equal or horizontal accountability;
3. Electoral outcomes are uncertain, opposition vote is significant, there is presumption of party alternation in government, and no group that adheres to constitutional principles is barred from forming a party and contesting elections;
4. No cultural, ethnic, religious or historically disadvantaged group is prohibited from expressing their interests in the political process, or from speaking their native language or practicing their culture;
5. Apart from elections, there are multiple and ongoing avenues for expression and representation of the citizens' interests and values, including a wide range of independent associations and movements they have freedom to form and join;
6. The sources of information are dispersed or democratized and access to them by the citizens is unfettered;

⁶Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, 2nd edition (New York: Harper, 1947), 269.

⁷See for example, Samuel P. Huntington, *The Third Wave: Democratization in the Late 20th Century* (Norman: University of Oklahoma Press, 1991), 5-13, especially 6.

⁸Robert A. Dahl, *Polyarchy: Participation and Opposition* (New Haven: Yale University Press, 1971).

⁹Diamond, *Developing Democracy*, 8.

¹⁰Robert A. Scalapino

¹¹Diamond, *Developing Democracy*, 11-12.

7. Individuals enjoy substantial freedom of belief, opinion, discussion, speech, publication, assembly, demonstration, and petition;
8. Equality before the law of citizens exists.
9. Individual and group rights are effectively protected by an independent judiciary whose decisions are respected and enforced by other power centers; and
10. The rule of law assures the observance of due process, including freedom from unjustified detention, exile, terror, torture, and undue interference in their personal life by the state and organized non state and anti state actors.
11. The existence and supremacy of a constitution that includes all of the above.

Contemporary liberal democratic political thought also stresses the crucial role of civic participation in decision making to ensure good democratic governance. At the very least, this means participation in the choice of political leaders in free, honest, and fair elections. Without popular participation, the governors can not claim popular support and political legitimacy. Without civic participation, official decisions are likely to be shaped only by the interests of traditional power holders or groups close to the centers of political power. These interests are often extremely narrow, particularistic, and inimical to the common good. Through civic participation, official decisions will be more likely to be informed by the views and interests of wider sectors of the population, and more likely, they will conduce to the good of the broader society.

Good democratic governance is also believed to be facilitated by bringing the decision making process as close to those

that would be directly affected by these decisions as possible. Effectively, this means decentralizing the locus of decision making and ensuring that all the stakeholders participate in the process. Through such mode of decentralization, local communities would have a better opportunity to identify relevant and key issues requiring government action, to more effectively influence the shape of decisions, monitor and provide feedback for them.

This is an innovation in governance that can make decision making more participative and more democratic, more responsive and more effective, more transparent and more accountable. It involves the devolution of functions that are better performed at the local level to the local government units with institutionalized participation of marginalized sectors, including non-governmental, and people's organizations in the decision making process. This system of governance is being tried in the Philippines through the Local Government Code of 1991. It is to this experiment that the discussion now turns.

The 1991 Local Government Code

Decentralization and devolution of power from the national to the local government is not new in the Philippines. Several laws were enacted under various administrations up to that of Ferdinand E. Marcos seeking to devolve certain powers to the local government¹², but none matches the scope of

¹²On various decentralization attempts in the past, see Gaudioso Sosmena, Jr., *Decentralization and Empowerment* (Manila: Local Government Development Foundation, 1991); and Alex B. Brillantes and Jocelyn Cuaresma, "Assessment of the Aquino Pilot Decentralization Project," *Philippine Journal of Public Administration* 35 no. 1 (January 1991).

devolution mandated by the 1991 Local Government Code (LGC). The enactment of the Code is required by the 1987 Constitution that seeks to promote popular empowerment through devolution of powers from the national to the local government and the institutionalization of the participation of marginalized sectors, including NGOs and POs in decision making. This ambitious program of devolution has earned the recognition by specialists in public administration as “an innovation in local governance” in developing and democratizing countries.¹³

The Code provides for the devolution of powers to the local government units (LGUs): (1) in the five functional areas of agricultural extension, health, social services, maintenance of public roads and highways, and environmental protection; (2) in the enforcement of certain regulatory functions such as the enforcement of forestry laws, certain franchising and licensing authorities; (3) increased financial resources available to the LGUs by raising their share of the internal revenue allotment from 11% to 40%; (4) granted them the power, to enter into financial transactions for local projects, such as to borrow from government or Private banks and to use credit financing schemes provided by the Code, including receiving financial grants or donations from foreign sources with the approval of the relevant national agency; and, (5) provided the legal framework for institutionalizing the active involvement and participation of NGOs and POs in decision making at the local level.

¹³See for example, Alex B. Brillantes, “NGOs and Local Development in the Philippines: An Innovation in Local Governance,” *ISDS GO-NGO Watch* Nos. 6-7 (January-May 1995) 4-8.

The implementation of the Code started in 1992. During the first four years of its implementation, 70,000 national government employees were devolved to the LGUs. Since then, the local share of national tax revenues has increased from 11% to 40%, and LGUs also gained substantial new control over the local planning process and the resources found within their territorial boundaries.

LGUs with capable, dynamic, and creative local chief executives had experienced an improvement in governance through the support of highly trained technical personnel that provided relevant expertise to the local chief executive in planning and implementing development programs that became a key factor in the economic progress of their local unit. Civil society organizations, including social development foundations organized by the private sector (as part of their corporate citizenship thrust), encouraged the pursuit of excellence among LGUs by searching for and high-profiling model local government units through programs such as the “Galing-Pook Award” and documenting the best practices adopted by high performing local government units in the implementation of the Code.

No doubt the Code holds much promise for popular empowerment and democratic consolidation.¹⁴ These, can be achieved through various mechanisms provided for by the Code. The first is the devolution of power to the local level in the five functional areas mentioned above. The extent-of the devolved

¹⁴This argument has been made for example in Carolina G. Hernandez, “Innovations in Local Governance in the Philippines: A Case Study of Decentralization in a Unitary State,” Professorial Chair Lecture as Visiting Professor of ASEAN and International Studies, Centre for International Studies, University of Toronto, 1995.

powers depended on the kind of local unit involved (whether province, city, municipality, or *barangay* or village). For instance, in the area of health services, *barangays* are responsible for the maintenance of health and day care centers, general hygiene and sanitation; municipalities and cities for primary health care, maternal and child care, and control of communicable and non communicable diseases; while provinces are responsible for tertiary health care (maintenance of hospitals).¹⁵

The second set of mechanisms pertains to the strengthening of people's participation in governance through the representation of NGOs and POs in the local legislative assemblies and the various local special bodies (LSBs). Heads of *barangays* and youth councils have guaranteed seats in the local assemblies at the provincial, municipal, and city levels. Women, workers, and special groups present in the locality, such as ethnic groups or the urban poor in urban areas, farmers in rural farming communities, and fisherfolk in fishing communities must also be represented in these local special bodies. In addition, the code provides for plebiscite, referendum, initiative, and recall as instruments of popular participation. Among the LSBs where popular representation is required by the Code are:

1. the local development council, a quarter of whose membership is reserved for the NGOs;
2. the local Prequalification, Bids and Awards Committee for infrastructure projects in which two positions are reserved for NGOs that are represented in the local development council;
3. the school board where a representative each of the youth, teachers organizations, and the non academic personnel of public schools in the locality, as well as the president of the federation of the Parents-Teachers Association sit;
4. the local peace and order council with three private sector representatives; and
5. the local health board in which sits a representative from the private sector or NGO involved in health services.

The creation of new LGUs and the merger or abolition of existing ones requires the approval of the people in the affected areas in a plebiscite. Local initiative can be started through petition by 1,000 registered voters in the case of a province, municipality, or city, or by 50 in a *barangay*. This is a legal process where the registered voters in the local unit may directly propose, enact, or amend any local ordinance. When passed, it cannot be repealed, modified, or amended by the local assembly within six months of its approval.

The people also have the power to remove by recall an erring elected official at all levels of local government. There have been a few instances when disgruntled members of the local constituency, usually led by the incumbent's political opponent invoked the power of recall. The outcome is varied - sometimes the recall process led to the removal of the incumbent, at other instances, the recall process failed because the incumbent enjoyed wider popular support.

A third set of mechanisms pertains to the increased revenues for LGUs. Apart from an increase in the LGU share of the internal revenue at location, the Code also increased their share from various other taxes. The

¹⁵Ibid., 16-17

fourth set of Mechanisms strengthens the powers of local chief executives and assemblies. Apart from the devolved powers in the five functional areas, the local chief executives have been given broad appointment powers.

The powers in the five functional areas can enable creative, dynamic, and innovative chief executives to undertake programs and projects for sustainable development with the participation of the community's representatives. Particularly in the area of environmental protection, the experience in the Philippines and in other parts of the developing world suggests that without community involvement and participation, such enterprises usually fail. Making the community stakeholders is likely to ensure the success of the enterprise.

Key to democratic governance is the creation of an environment where as many citizens as possible acquire a stake in maintaining democracy until a national consensus that it is the only viable and acceptable form of governance is achieved. Clearly, the Code presents an opportunity for building this consensus if it succeeds in empowering people and making government more effective, more transparent, more accountable, and more responsive. Its empowering provisions outlined above can be used to ensure that citizens can exercise their right to participate directly in making decisions in matters of direct relevance to them. The mechanisms for making government more responsive, more accountable, more transparent, and more effective are also within the reach of civil society organizations that have the capacity, commitment, and political will to use them. Here, a conjunction of capacity, commitment, and political will between the local

chief executives and the NGO/PO representatives in the LSBs is crucial and necessary for success.

The Code is not perfect. There were problems encountered in the process of implementation. There are risks that the devolved powers could be misused or abused by corrupt local chief executives, particularly in areas where elements of civil society are weak. Much is required by way of strengthening civil society organizations so that they can be more effective participants in local governance. Much is also required to enhance the technical and institutional capacity of LGUs to discharge their newly devolved functions more effectively and to use their newly acquired powers responsibly. But the Code can be a promising beginning to improve governance, to empower civil society, and to promote meaningful participative democracy in the Philippines.

Civil Society in Democratic Governance

The most important aspects of the Code for this discussion are those that cover the participation of civil society, organized as NGOs and POs in local governance. As already noted, these organizations have a right to be represented in the local special bodies. This is done through a system of accreditation with the relevant local government. Interested NGOs/POs went through the accreditation process and when successful, they participated in the choice of their sector's representatives in the LSBs. Depending on the character and socioeconomic profile of the local government unit, the representatives from civil society organized as NGOs or POs could vary widely, except for the representatives of the women's sector. This

sector is always represented in the LSBs regardless of the particularities of the LGU. One of the problems encountered in this regard is the lack of understanding and gender sensitivity by many local chief executives. They thought that being a woman chief executive qualifies them to represent the women's sector. This is one of the challenges that need to be met if appropriate civic representation in decision making is to be properly implemented.

The accreditation process and the character of the civil society organizations that sought to participate in the process also presented some problems. Many local chief executives were not fully familiar with the Code, especially those that pertained to civic participation in local governance. When they found out that these organizations would be represented in local decision making bodies, a good number hurriedly organized their own NGOs/POs and made them go through the accreditation process. This practice gave way to, the distinction being made between these organizations and those that were truly voluntary and autonomous of the ruling elite. The former is sometimes called GONGOs (Government Organized Non-Governmental Organizations) or GRINGOs (Government Regulated and Initiated Non-Governmental Organizations).

In many rural areas, there were no NGOs or POs. Consequently, civic organizations such as church-based organizations (Daughters of Mary Immaculate, Knights of Columbus, etc.), Girl Scouts or Boy Scouts of the Philippines, 4-H Clubs, and the like took the place of NGOs/POs in obtaining accreditation for local governance representation. Moreover, the traditional suspicion between grassroots organizations and government im-

peded the process of institutionalizing the participation of NGOs and POs when the latter did not wish to participate in the process for fear of cooptation by government. They were also concerned over the issue that if they became part of the decision making process of government, they would lose their NGO/PO credentials and credibility. Nevertheless, most of the LGUs were able to put in place an infrastructure for NGO/PO representation in local governance. But whether this led to greater democratic governance or the strengthening of the power of the local chief executive again depended on many factors.

The experiences of the LGUs varied, largely because they varied widely (along many geographic, economic, political, social, environmental, and other dimensions), and so did the quality of their chief executives and their staff, and the quality and institutional capacity of participating NGOs and POs. The most successful ones were able to transform their communities into progressive and dynamic units where local resources were harnessed to benefit many of their citizens.

One of the most important mechanisms in ensuring the inputs of civil society in local decision making is the consultation process in the generation and implementation of local development projects. Local chief executives have varying approaches with regard to this mechanism. In some cases, consultation with representatives of NGOs and POs has been practiced and has worked successfully, in others this consultative process was skipped altogether by an assertive local chief executive, also with successful results.

Among the examples that may be cited are the winners in the Galing-Pook Awards, such as the Municipality of Irosin in Sor-

sogon Province located in one of the poorer areas in the southern part of Luzon Island. Its mayor organized a development planning workshop after his election in 1992 in which representatives from NGOs/POs, cooperatives, *barangay* captains, business people, and landowners participated. They formulated the municipality's vision, mission, and strategy that formed part of Irosin's integrated area development plan. Irosin has since been upgraded from a fifth to a fourth class municipality.¹⁶ Here, there was active participation of various civil society representatives in the generation and implementation of the integrated area development plan that the mayor himself sought to develop through consultation with and involvement of these representatives.

A different example of "successful" local governance is the case of Marikina, an industrial town in Metro Manila. Its mayor, a construction magnate successfully transformed Marikina from a town plagued by filth, crime, and pollution into Metro Manila's cleanest and greenest town, primarily by himself. External help took the form of technical assistance from experts to clean up the polluted Marikina River. There was no consultation with the local development council, although the town's business association helped in the implementation of the project to rehabilitate Marikina River.¹⁷ Here, there was "successful" local governance, but little civic participation and only in the implementation of the project. Democratic governance was ignored. The issue that can be raised is whether this can be considered an example of "good" governance.

¹⁶http://www.codewan.com.ph/CyberDtaryo/archives/feat_21.htm

¹⁷*Ibid.*

Perhaps not, if good governance includes participation of the citizens in the decision process.

The Issue of Transparency

While the constitutional and legal infrastructure for civil society participation in democratic governance has been put in place and is in the process of implementation in the Philippines, corruption and lack of transparency has reared its ugly and sinister head once again. The World Bank Report on corruption in the Philippines is a timely wake up call for the administration of President Joseph Ejecrito Estrada (Erap) to put its house in order. The telling World Bank analysis that "an explicit and credible anti-corruption strategy governing transparency and good governance will be essential to give [it] the comparative advantage in the competition"¹⁸ with its Asian neighbors that are recovering from the crisis punctures the exaggerated claim of government and shook up the complacency of his cabinet about the state of the economy. With his popularity rapidly declining due to a number of causes, this report is only likely to hasten this trend unless government undertakes serious reforms to promote transparency and good governance.

It is rather unfortunate that the Philippines has not taken the call for transparency, accountability, and good governance seriously; As the Southeast Asian country that first experienced the loss of political legitimacy of its leader due to corruption, cronyism, and bad governance that led to his fall, its current leaders, should have known better than not to take serious steps

¹⁸Amando, S. Doronila, "WB: Corruption in RP deep-rooted," *Philippine Daily Inquirer*, 7 November 1999, 1.

to combat corruption. The recent example of Indonesia where a long-standing ruler was deposed on the issues of corruption, collusion, and cronyism seemed not have influenced the present administration in Manila to govern the country better.

Unless the present administration reverses the situation and heed the World Bank assessment, it is likely that President Estrada's political capital will continue to erode rapidly and could reach dangerously low levels in the near future. Corruption is not his only problem, but even on its own it is sufficient to create a huge public outcry that could have serious implications for the country's political stability and economic recovery.

Concluding Remarks

The role of civil society in democratic governance is a very critical one. Representing the voices and interests of various groups between the family and the state, civil society's participation in governance ensures that these are taken into account in the decision process. When functioning properly, civil society can also serve as a feedback mechanism to enable government to determine whether its policies and programs are responsive to public welfare. Civil society can also serve as a watchdog that can limit lack of transparency in decision making and given the requisite legal mechanisms, can demand responsive and responsible government.

In the Philippines, the 1991 Local Government Code has provided a legal framework for the institutionalization of civic participation in democratic governance. It can serve a useful facilitating factor for democratic consolidation and popular empowerment. However, while the legal framework exists, much depends on the quality of, local

chief executives, including their commitment to and respect for democratic governance. The other component of successful use of this legal framework for democratic governance is civil society organized as NGOs and POs. They must also possess institutional capacity for meaningful civic participation in democratic governance. Collaboration between the local chief executives and these representatives of civil society is imperative for success.

While the experience of civic participation in democratic governance in the Philippines suggests a mixed outcome, where in some cases civil society representatives were able to avail of the window of opportunity to participate in decision making and in others, the devolved powers created new local bosses or reinforced old ones, some studies of the devolution process indicate that this has further broken up the clientelistic basis of Philippine politics. The devolution of power to the local government units has combined with the forces of urbanization, industrialization and the revolution in information and telecommunication technology to alter the old patron-client basis of politics. A transformation of the political culture to fit the altered basis of politics needs to take place.¹⁹ On the whole, however, the sense is that devolution, though challenged by difficult problems, is contributing to the enhancement of local empowerment not only of local government units but also of civil society. It is also serving the goal of democratic governance.

¹⁹Gary Hawes, "Local Politics in a Decentralized System: The Structural Impact of the 1991 Local Government Code in the Philippines," a paper presented at Session 82: Decentralization and Democracy: Exploring the Linkages in the Philippines, 1997 Association of Asian Studies Annual Meeting, Chicago, Illinois.

Strategic Pillars of the Pacific Rim

Wilfried A. Herrmann

IF one analyzes the macropolitical conditions in the Pacific region, it is of primary importance to consider the regionally relevant powers in the Asian-Pacific region, the People's Republic of China, Japan, and the United States of America. The reason is most experts assume that the Asian-Pacific region due to the dynamic economic growth, the still growing population potential, the increasing educational level, the cultural adaptability, and other factors and despite the 1997 financial crisis will become a new pivot of international economy in the 21st century. Consequently one can call for the above-mentioned regional powers' commitment in this region.

An essential point in this analysis is the fact that the power structures in the Pacific region undergo a slow, but obvious transformation. While the United States has considered itself as the only (super)power playing a stabilizing role and will continue do so in the foreseeable future, the People's Republic of China, Japan, India, Russia, and possibly later also a then united Korea become emancipated and develop strong strategic interests and demands. At the same time, there seems to be a strong indication that the People's Republic of China is on the "long march" towards the Asian leading power's position. The economic potential, the build-up of military capacities including power projection capabilities, and the more self-confident appearance in the international political system after Hongkong's return in

1997 support this thesis. On the other hand, Japan's special approach in terms of security policy comes to an end, because the North Korean missile test on 31 August 1998 has produced a Japanese "Sputnik shock" with results that were comparable to those of 1957 in the United States. With respect to Japan's domestic policy, this shock will pave the way for a more active military support of the United States in times of crisis and war.

The United States as a Stabilizing Power

In the Pacific region, the United States are the politically, economically, and militarily dominating power, even though the situation in the Pacific region is more diverse than in the Euro-Atlantic area. This is primarily caused by the United States' partners and opponents who are committed only to bilateral agreements and arrangements such as the Japanese-US defense guidelines or the South Korean-US treaties, while lacking a regional security organization similar to NATO.

On the other hand, the United States' ambivalent attitude often results in irritation, e.g. for one thing there is the Taiwan Relations Act of 1979 providing for support to be rendered to Taiwan in case the Chinese mainland launches an act of aggression, and for the other particularly the Clinton administration maintains good or even very good contacts with Beijing. In July 1998 it has again emphasized the "3 nos" claim

(no diplomatic recognition and support of Taiwan, no support of an independence movement in Taiwan) put forward by the People's Republic of China. This mainly results from the United States' strategic reorientation towards a "geoeconomically" motivated approach which has "demilitarized" and increasingly "economized" its total political thinking. Thus, the security risk posed by the People's Republic of China, has been pushed into the background in favor of expected economic advantages, a process which has a considerable influence on the Pacific region, where the United States performs a function of strategic balance.

Therefore, the rapprochement between the United States and the People's Republic of China has resulted in uneasiness on the part of Japan and the smaller allies in the region -- according to an Asian proverb "When elephants make love, the surrounding grass is pressed flat." Up to the present, however, this has not yet been noticed by the Clinton administration. This is also reflected in the new "United States Security Strategy for the East Asia Pacific Region" (EAPR) of November 1998 which was designed to compensate for the lacking political Asia concept of the Clinton administration and the resulting discrepancy between the economically motivated and security attitude of the United States. This discrepancy also became evident in the Asian financial crisis in 1997, during which the United States helpfully took action at a very late point and hardly noticeable to the Asians.

On the contrary, the measures taken by the International Monetary Fund (IMF) perceived by the Asians as being US-led were considered to be a disgrace to the Asian self-confidence. As a consequence, many Asian nations are now expecting a greater

commitment from the United States to a resolution of the Indonesia problem. But against the background of the experience gained during the Kosovo crisis in Europe, nearly all leading circles reject an employment of US-led UN troops in the region.

In military terms, the "withdrawal" of the United States at the beginning of the '90s and the simultaneous emphasis placed on "commitment" have considerably irritated the region. Nevertheless, the United States' balancing function cannot be replaced in this region. The discussion about establishing a theater missile defense system (TMD) in Japan and maybe also in South Korea and Taiwan, which started at the beginning of 1999, has reassured the affected countries about North Korean and Chinese missile threats. So, the United States have reestablished its security credibility in the region, a credibility which had partly been lost.

The People's Republic of China -- the New Leading Power in Asia?

With all its power and with all consequences, the People's Republic of China strives for the status of a "superpower of the 21st century." In terms of foreign policy, the Chinese freedom of action has basically been restricted only by the relationship with the United States which has been clouded by the human rights and proliferation problems. By comparison, the bilateral relations between the People's Republic of China and Japan as well as the Southeast Asian states have been stable or even good. The integration into the "ASEAN-Post Ministerial Conference" (ASEAN-PMC) has clearly broadened the basis of Chinese policies.

In economic terms, "Greater China" with its "Chinese Economic Area" (CEA/together

with Taiwan and the “Special Administrative Region Hongkong”) and the support provided by the Overseas Chinese is on its way to an economic world power. The financial crisis in 1997 has shown that the People’s Republic of China wants to assume this role and will be able to perform it responsibly. If the People’s Republic of China had not acted responsibly by contributing US\$1 billion to the IMF relief fund and refraining from devaluing its currency in the general speculative operations, this would have resulted in a worldwide economic crisis of unimaginable dimensions stated the IMF chief economist Stanley Fisher in a meeting with the author. In addition, a change towards geoeconomic thinking is indicated by the personnel selection of the political leaders and the decisions of the 15th Party Congress of the Chinese Communist Party. They clearly strengthened the economic reformers’ position, so that the economic process of opening becomes irreversible. By its own account, the People’s Republic of China will have achieved the status of a medium-developed country on its entire territory by the year 2050, an objective which seems to be quite realistic from today’s point of view.

In terms of security policy, considerable changes in the defense policy and military strategic considerations of the People’s Republic of China have been brought about since the ’70s. From approx. 1975 to 1985, Mao’s doctrine of the “People’s War” was applicable. The “People’s War” was designed to be conducted on modern conditions. Thereafter, the Chinese military leaders began to revise their thinking; this was pushed forward by the experience gained during the Gulf War in 1991. The basis for new and modern structures and doctrines of the Peo-

ple’s Liberation Army (PLA) is now provided by quality and no longer by quantity. This means that modern weapon technology, logistics as well as command and control systems have become the decisive factors for an evaluation of their own military strength. However, the People’s Republic of China has a great backlog in the above-mentioned areas and they, too, are well aware of this fact. Currently, the armed forces of the People’s Republic of China consist of

- the active Army (comprises all the services) plus reserve forces = People’s Liberation Army (PLA);
- the armed police;
- the militia.

Since the ’80s, the military organization has permanently been subject to far-reaching structural changes. As early as 1985, the military regions were reduced from 11 to 7, the 36 “field armies” were reorganized into 24 “basic armies,” and the armed forces’ total personnel strength was reduced by 1 million soldiers (from 4 to 3 million). Since 1997, a new reduction program that had been implemented was designed to further reduce the armed forces by 500,000 troops by the year 2000. In parallel, the military ranks were reintroduced, a measure taken to indicate the armed forces’ tendency towards professionalization. This also includes the extensive modernization measures which have been taken since 1988.

The modernization of the ground forces is primarily based on the transformation of selected units into “rapid reaction forces” and a simultaneous increase in both mechanization and motorization. The introduction of “special branches” such as armor, artillery, electronic warfare, and air defense corps is designed to make the new forces more ef-

fective and improve their operational readiness in terms of rapid deployment. Therefore, joint training is attached more and more importance in the training concept of the People's Liberation Army. However, the new forces require (strategic) airlift capacities ensuring that they can be adequately employed. Consequently, the lack of strategic mobility in addition to the lack of C3I capacities presents the greatest difficulty for a smooth and efficient modernization of the ground forces. Therefore, priority in terms of qualitative modernization is now given to the communications technology as well as to the air force and navy. They have built up the biggest backlog in the modern weapon technology sector due to the fact that they were neglected during the years of the "People's War Doctrine." The operational range of the air force is to be extended to up to 930 miles with the conditions of modern warfare prevailing. That is why the People's Republic of China bought approx. 30 SU-27 FLANKER fighter bombers (in 1997) and 50 SU-30MK (in 1999) from the Russians and concluded follow-on licensing agreements in June 1999 which included approx. 250 new constructions and technological improvements. However, the Chinese air force is still far from attaining their general objectives since key components of the new strategic air concept, i.e. AWACS and air refueling, are still not available. Chinese experts work intensively in both fields; yet a rapid success cannot be expected.

The naval forces also received new materiel (LUHU/class destroyers, JIANGWEI/class frigates) designed to enable the Chinese Navy to conduct operations analogous to those of a "blue-water navy" (up to now "brown-water navy," i.e. coastal defense

navy). At the same time, the main maritime mission which up to now was to support an amphibious landing on Taiwan has changed; today, key importance is attached to the capability of securing the 200-mile "Exclusive Economic Zone" (EEZ). Although some of the procurement orders involve a considerable volume, the neighboring Asian countries watch this development calmly, but attentively. In their view, the modernization of the Chinese armed forces is conducted within a scope which is acceptable to all neighbors in view of the technological deficit of the People's Liberation Army (PLA). Some South East Asian experts, however, consider the delays of their respective nations' modernization programs resulting from budgetary reductions made after the financial crisis in 1997 with mixed feelings. If the frozen programs can be started again within the next 5 years, the regional balance of forces *vis-à-vis* the People's Republic of China can be satisfactorily organized. If only the People's Republic of China and Taiwan further modernize and rearm, a regional imbalance will occur in a way that most Asian experts would not regard as a threat, but view with concern.

A brief look at the military budget of the People's Republic of China confirms the above-mentioned tendencies. While, in recent years, the economy grew by approx. 9% annually, the military expenditures increased by approx. 14% per annum to about US\$35 billion (in 1998) during the same period of time (official figures). Although the figures clearly do not reach the expenses of the United States or Great Britain, the lacking transparency of Chinese figures has frequently given rise to criticism on the part of the international community. So far ef-

forts for more transparency in this field cannot be made out, but in the long run even the People's Republic of China will hardly be able to close its mind to the international pressure for more transparency in its military budget.

Although there are currently no burning problems in the environment of the People's Republic of China which in military terms could rapidly escalate, experts keep an eye on a number of conflict potentials as follows:

- the Taiwan Strait where the conflict between Taiwan and the People's Republic of China takes place;
- the South China Sea with the Paracel, and Spratly Islands to which not only the People's Republic of China, but also Taiwan, Malaysia, Vietnam, the Philippines, and Brunei Darussalam lay claim totally or in part because of the oil and/or natural gas deposits as well as fish populations expected there;
- the Senkaku/Diaoyu Islands which are disputed by Japan, Taiwan, and the People's Republic of China;
- the establishment of Chinese radar and harbor capacities in the Andaman Sea (150 nautical miles north of the Indian Nicobar Islands) which strengthens Asian experts in their opinion that for about the year 2030 a conflict between China and India over the important sea lanes of communication (SLOC) between the Indian and the Pacific Oceans in terms of maritime strategy has to be expected.

Aside from the Taiwan problem which for the People's Republic of China is of a domestic nature, there are primarily economic and strategic reasons which attach importance to the above-mentioned regions for the

People's Republic of China and its neighbors, e.g. expected oil and natural gas deposits, dense fish populations or control over important SLOCs. However, the premise that any interests in these areas have to be pursued if possible without any employment of military means (analogous to the "Art of Warfare" by the Chinese thinker SUN TZU) is particularly important to the Chinese leaders.

Digression: Taiwan

For a better understanding of the Chinese positions, a brief digression on the Taiwanese developments seems to be useful.

Since the beginning of the 90s, Taiwan's domestic system has been subject to fundamental changes. After President Lee Teng-hui had put an end to the period of communist rebellion and the actual state of emergency linked to it in 1991, the election for the second legislative period since 1947 (at that time still held in China) was held in 1992. Though the ruling Kuomintang (KMT) obtained an absolute majority, the democratic electoral structures also offered opportunities for the ethnic Taiwanese to reform the old anticommunist order and force a democratic restructuring of society.

During the election campaign, the different positions of the KMT and the opposition, above all the Democratic Progressive Party (DPP), became apparent. While the KMT put an emphasis on the reunification with the People's Republic of China, the DPP supported Taiwan's independence. Despite the political campaign for Taiwan's readmission to the UN which started again in August 1999, the KMT's objective has remained unchanged. This initiative failed again as the People's Republic of China not

only has a permanent seat in the UN Security Council, and thus a right of veto. Moreover, the People's Republic of China has used its newly won scopes for action after the end of the Cold War for establishing new diplomatic relations in the Asian region. This, however, is done at the expense of Taiwan, for the People's Republic of China takes up relations only on condition that Taiwan is treated by the respective country as a province of the People's Republic of China. Therefore, Taiwan has been put under strong political pressure by Beijing, particularly since the number of Taipei's diplomatic relations had already been decreased in the '70s due to the recognition of the People's Republic of China by the United States. Although, during the last few years, Taiwan has been able to enter into diplomatic relations with some of the smaller Central American and African countries after having provided generous foreign development assistance (FDA), so there are currently 29 states recognizing Taiwan as Republic of China, among them the Former Yugoslavian Republic of Macedonia. This made the employment of UN troops in this country within the framework of the Kosovo conflict impossible.

Nevertheless, because of its economic performance, Taiwan maintains very good economic relations in the Asian region. It is one of the largest investors in the Asian region (including investments in the People's Republic of China). Therefore, Taiwanese money flows into nearly every Asian state (exceptions are Japan and Brunei Darussalam) and meanwhile also into European states (e.g. the Baltic states). But the Taiwanese economy is considerably dependent on the US market; thus there is always a risk that the United States will impose economic sanc-

tions to reduce the US trade deficit *vis-à-vis* Taiwan.

In recent years, Taiwan has started to counter this threat by liberalizing its own trade and investment policy in the People's Republic of China. These activities culminated in the Taiwan Strait Agreement of 1993, which was concluded between high-ranking -- but not official -- delegations from Taiwan and the People's Republic of China, the "Association for Relations Across the Taiwan Strait"/ARATS for Beijing and the "Taiwan's Straits Exchange Foundation"/SEF. With that Taiwanese companies are in a position to do both invest and produce in the People's Republic. The products are then exported from the People's Republic to the United States. This is reflected in the Sino-US trade balance, while the surplus in Taiwan's balance of trade with the United States is decreasing. The profits, however, are partly transferred to Taiwan so that it obtains more foreign exchange receipts, and the high level of Taiwan's exchange reserve can be maintained. So Taiwan comes closer to its objective of achieving the status of a developed country in the medium term, even though the internal conditions have changed for the worse due to increasing development expenses and labor costs. All in all, the economic development has to be considered to be positive. Nevertheless Taiwan will further have to live with the discrepancy of being highly respected in economic terms on the one hand and having only a low political profile in the region on the other.

In the security/military area, Taiwan has technically well equipped and efficient armed forces which are continuously modernized. They preventively serve to deter the Peo-

ple's Republic of China from an intervention and in operations they serve to defend Taiwanese territory. However, Taiwan can built up its defense only on the basis of the Taiwan Relations Act (TRA) of 1979, which promises substantial US assistance in times of crisis. Therefore, it was hardly any surprise when in 1995/96, during the Chinese missile tests off Taiwan, the United States had two aircraft carriers with their battle groups steam through the Taiwan Strait in order to emphasize its interests in the region. With the Chinese reactions having cooled down, the atmosphere has been heated again since the spring of 1999 because Taiwan wants to be included in a strategic US missile defense belt. This has resulted in discontent on the part of China for the theater missile defense system (TMD) which is being built up by the United States in cooperation with Japan and could be expanded to Taiwan and South Korea, could definitely change the strategic balance in the Pacific region to the disadvantage of the large regional landpower, the People's Republic of China.

To sum up it can be said that Deng Xiao-ping's economic reforms have led to a period of incredible growth and social change in the People's Republic of China. Many external influences were exerted on the formerly more or less isolated country, a phenomenon often presented as a consequence of globalization in the People's Republic of China. For this reason, the stability of the political order is no longer guaranteed as it was before -- some experts even see it endangered in the future.

A core area in foreign policy which does not allow any compromise is the unresolved status of Taiwan. Whenever the "one China

policy" is questioned, the center of the definition of China's national integrity is hit. For Beijing, Taiwan's unilateral declaration of independence would be the "casus belli". Nevertheless, future efforts of expansion on the part of the People's Republic of China seem rather unlikely in the long run, even though it has clearly expressed its position on the controversial territorial issues concerning the Paracel and Spratly Islands as well as Taiwan, i.e. its conviction that these territories belong to the People's Republic of China as far as their sovereignty is concerned. On its way to becoming the leading power in Asia, the People's Republic of China has implemented important foreign-policy decisions since the reintegration of Hongkong in 1997. These decisions, which have been noticed also on a global level, involve:

- Efforts made by the People's Republic of China to influence North Korea's "solo efforts" in accordance with the convictions of the international community, i.e. to call for a termination of the North Korean nuclear program.
- Efforts to exert political pressure on Pakistan by reducing the political and practical support after its nuclear test in May 1998.
- Moderation exercised in monetary policy paralleled by a further opening of the own economic area in connection with the Asian financial crisis in 1997.

These actions taken in the foreign policy sector reveal the changed political self-image of the Chinese leaders and their grown sense of responsibility at the international level. This development, however, has not sufficiently been observed and respected by the Western nations.

Japan -- the End of a "Special Way" ?

Since the House of Representatives elections of July 1993, which, after a rule of more than 40 years, replaced the Liberal Democratic Party (LDP) by a coalition government (firstly without but later including the LDP), Japan's domestic policy has been subject to radical changes, and this phase is expected to continue for some more years. Although the subsequent governments under the prime ministers Hosokawa to Obuchi primarily concentrated on domestic policy, they also set new directions in foreign policy (e.g. they apologized for Japan's wars of aggression and its colonial past), which was received positively above all in South Korea and (to a moderate extent) in the People's Republic of China.

Japan pursues two important objectives in the foreign policy sector which can be described essentially with the words of a Japanese expert in Tokyo (1993): "The first objective is to keep the US involved and engaged in the region. The other is to ally the concern of Asian countries about resurgence of Japanese power in the region." This stresses the significance of the Japanese-US relations as a central element of Japanese foreign policy. Despite the fact that the bilateral trade relations are problematic due to a large deficit in the United States' balance of trade, the political harmony between the two nations is an important prerequisite for stability in the region. For this reason, Japan is looking for alternatives to prevent this relationship from being endangered.

Another important element of Japanese policy is the Japanese-Russian relations which are strained by the Kurile Islands is-

sue. Moreover, Japan does not see any essential change in the strength of the forces deployed on Russia's Asian territory; i.e., from the Japanese point of view the threat has not decreased to the same fundamental extent as in Europe. Nevertheless, bilateral efforts made for concluding a peace treaty have been intensified since the meeting of the Japanese Prime Minister with the Russian President in 1997. These activities, however, have been furthered by the fact that Russia's political, military, and economic influence on the Asian-Pacific region has considerably decreased which opens new fields of activity to the Japanese (e.g., in Vietnam, Laos, Mongolia). In the long term, the Japanese economy dependent on resources will be offered good chances of meeting its raw material requirements, and therefore, an easing of tensions between the two nations is to be expected in the medium term.

For geographic, historical, and economic reasons, the Japanese-Korean relations are an exception. The reunification problems of the two Korean nations are at the core of the Japanese relations with South Korea. For this reason, Japan has been seeking talks with North Korea which, from the Japanese point of view, has been disappointing because the North Koreans demanded compensation for the time after World War II. In addition, the bilateral atmosphere has been strained by the North Korean nuclear programs and the launch of the North Korean TAEPODONG I intermediate-range missile in August 1998. Nevertheless, Japan, supported by the US and South Korea, will continue to seek talks in order to contribute to a peaceful solution on the Korean Peninsula. In this respect, close and intensive contacts have been established between South

Korean and Japanese politicians which contrasts with the psychological rejection of the Japanese by the Korean people.

In economic terms, Japan in addition to the United States is the key nation for the Asian-Pacific region. The empire pursues a global economic policy characterized by short supply routes to the production centers, inexpensive production bases, and thereafter short routes to the markets. In this concept, the "small dragons" (South Korea, Taiwan, Singapore) and the "Association of Southeast Asian Nations" (ASEAN/Brunei Darussalam, Burma, Indonesia, Cambodia, Laos, Malaysia, the Philippines, Thailand, Singapore, Vietnam) are of central importance to the Asian-Pacific policy of Japan. The technologically highly developed countries of this group support the Japanese technology transfer to the region; the less developed countries have cheaper manpower than Japan and can therefore contribute to the economic success of Japanese enterprises.

In the medium and long term, the above-mentioned countries represent an important future market for Japan due to the economic development prognosticated for the time when the 1997 Asian financial crisis was overcome. This perspective is very important to Japan because since 1995 (actually long before the Asia crisis itself) the country has experienced an intensive recession. During this time, Japan changed from an economic paragon into a problem due to obsolete political and economic as well as problematic financial structures (e.g. banking system/banking scandals/credit practices). Back in 1995, the British Economist already tersely stated that in the next few years the greatest threat to global stability would emanate from Japan.

Meanwhile, there have been clear indications that the recession mentioned will come to an end. Support measures taken by the Japanese government (with 24 trillion Yen, i.e. about 350 billion DM, the government has put together the largest economic package Japan has had till now) and political and economic reforms in connection with a relative opening of the Japanese market for international products have altogether released a positive tendency. Well-known economists see the Japanese economy operating again in the black at about the end of 1999.

In Japan, the radical security changes in the Asian-Pacific region (the development of the People's Republic of China into a regional great power, the emergence of the new "nuclear powers" India and Pakistan in 1998, and the increasing threat posed by North Korea) have also led to a process of rethinking in the defense policy area. The last impetus was given by North Korea's TAEPODONG I intermediate-range missile test on 31 August 1998. One stage of this missile flew over Japanese territory before it plunged into the Pacific Ocean. Although also American specialists confirmed later that this had been an attempted transport of a satellite to the outer space, the whole of Japan suffered a severe shock -- comparable with the "Sputnik shock" felt by the Americans in 1957! Since then, the political establishment and wide sections of the population have developed an essentially more positive attitude towards national defense and the armed forces than during the years since World War II.

Therefore, the Japanese government was able to push forward a consolidation of the military alliance with the United States, which

was based on the Japanese-US security treaty of 1960, and at the same time meet the US demand for burden-sharing. The revised version of this security treaty stipulates an asymmetric obligation to render assistance, i.e. the United States commits itself to defend Japan in case of an attack on Japan; however, there is no such Japanese commitment to assist the United States, a fact which has somewhat been modified by the "extended defense guidelines for the US-Japanese defense cooperation" of September 1997. Up to that time, Japan had only been obliged to provide bases to the United States. Despite some incidents with soldiers stationed there, this was rather unproblematic for Japan, although the United States has stationed about 47,000 soldiers on the Japanese islands. And over the years, an increasing share of the costs incurred (up to 70%) has been paid by Japan.

Essential points of the new bilateral agreement passed by the Japanese legislative only after the "TAEPODONG shock" are ensurance of logistic support to be rendered by Japanese units to US forces employed in the Asian-Pacific region (e.g. sealift of personnel, materiel, and POL to US ships at the open sea), assistance in evacuation operations, and cooperation in minesweeping operations at the high seas. Thereby, Japan has consolidated its position as the most important ally of the United States in the Pacific region and at the same time met significant demands made by Washington.

Nonetheless, these close ties between Japan and the United States and the extended regional responsibility of the Japanese Self Defense Forces (SDF) involved have provoked harsh criticism in the People's Republic of China and North Korea. Therefore,

Japan continually endeavors to describe this "alliance" as a mere measure of self-protection which is not directed against anybody. In this context, it is important that the Japanese government makes clear in public that Japan does not lay claim to any military leading role in Asia and that, after the disintegration of the Cold War structures, the Asians, in Japan's view, should pursue their security interests to an increasing extent by themselves in order to preserve both peace and economic prosperity in the long term.

In spite of an increased commitment in terms of security policy and an recognizable armament of the Japanese SDF, there are no indications that Japan's military role is increasing. The reasons for that lie in the fact that the SDF are strictly bound by the provisions of the Japanese constitution. In this context, Article 9 is to be mentioned which reads as follows: "The Japanese people forever renounces war as a sovereign right of the nation and threat of force or use of force as means to settle international disputes." Moreover, this Article stipulates that Japan may not possess any ground, naval or air forces or other means for the purpose of warfare. For this reason, Japan still has only "self-defense forces."

To sum up it can be said that Japan, although economically dominating Asia, has to be seen as a "soft giant," because its political and military means and capacities are limited. This means for the Japanese governments that they have to implement sweeping political, economic, security and politico-military reforms in order to establish the necessary prerequisites which may then contribute to the nation's strengthening, make the assumption of more responsible tasks within the international framework

possible, and finally ensure Japan's indispensable contribution to stabilization in the Pacific region. At the moment, Japan seems to be well on the way to achieving these goals and -- once having made it -- it can dissociate itself from its previous special role of a dependent of the United States and become a normal, large nation.

Concluding Notes

The essential aspects of the security developments in the Asian-Pacific region are that:

- the power structures in the Pacific region undergo a slow, but clearly recognizable transformation;
- the United States has established itself as the only stabilizing power up to now and will continue to do so in the near future;
- the People's Republic of China is on its way to becoming the leading power in Asia;
- Japan's special approach in terms of security policy is drawing to a close; this development was triggered by the North Korean missile test of 31 August 1998 (Japanese "Sputnik shock").

The other regional powers are of secondary importance for the Asian-Pacific region, even though some important strategic tendencies are worth mentioning. This includes above all that Australia has clearly turned towards Asia with respect to the economic and security sector -- which not least has become evident in the role of the lead nation within the framework of the UN mandated mission in East Timor (INTERFET) in 1999 -- in order to establish itself as an "Asian power." Moreover, India has been

increasingly included in the experts' current analyses. This results from the fact that India declared itself a nuclear power in May 1998, and has consistently used the reorganization of the global system for enlarging its sphere of influence in the Southeast Asian region. At the same time, this has resulted in an increased importance of the Indians living abroad as an economically relevant group, and in the long term (in about 2025) it opens the possibility of a conflict of interests between the People's Republic of China and India concerning the sea lines of communication in the Pacific and Indian Oceans. On the other hand, Russia is not attached any importance in the region in the short and medium term, although the Asian experts prognosticate a long-term recovery which, however, will not again lend that weight to Russia it once possessed.

Meanwhile, the conflict on the Balkans has focussed on the political and particularly the security interest of the Europeans on this region. Due to this concentration, the fact is frequently overlooked that particularly in the Asian-Pacific region there are sufficient fields of conflict which can cause also global shifts at the economic and political levels. These fields of conflict primarily include the (verbal) disputes between the People's Republic of China and Taiwan over the status of the island republic, the challenges on the Korean Peninsula, and the current events in East Timor (Indonesia). These above-mentioned crises make two essential facts obvious,

- Security policy is a global issue and means more than considering military or other power potentials. All "fields of policy" are relevant to a stable, prosperous, and peaceful development.

- In Asia, a regional alliance for crisis control/crisis management comparable to NATO is not available and there is no indication that such an alliance will be formed.

Therefore, the Asian powers (these also include the United States) must develop strategies for a peaceful reconciliation of interests which will take Asian conditions and realities into account. In contrast to the European situation, however, the development into a multilateral system of interlocking institutions seems to be still a long way off. Consequently, the United States with their bilateral network in the Asian-Pacific region will remain the only stabilizing power in the foreseeable future, even though the emergent great powers, i.e. the People's Republic of China and Japan, want to participate more and more in the political decisions taken for stabilizing the region.

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Corporate Governance, Ownership Concentration and Its Impact on Firms' Performance and Firms' Debt in Listed Companies in Indonesia

Taridi

Introduction

Corporate Governance has recently become an important and emerging issue in East Asian countries. The term refers to the institutions and mechanisms in which suppliers of finance to corporations (owners) control managers to ensure returns on their investment. The crisis has made many East Asian countries realize the importance of good corporate governance as many believe that poor corporate governance has exacerbated the severity of the crisis.

In order to restore investors' confidence and to maintain economic stability and competitive advantage in the long term, East Asian countries have to improve their corporate governance. It aims to create well-functioning and competitive markets, strong legal protection for outside investors, either shareholders or creditors, and the condition in which outside shareholders can influence management's behaviour (Prowse 1998).

On the other hand, poor corporate governance practices such as inadequate disclosure, lack of independent oversight, and weak minority shareholders rights will dis-

courage investment and weaken incentives for efficient management. As Stone, Hurley and Khemani (1998) pointed out these poor corporate governance practices have led to high concentration of ownership, rent-seeking behaviour, and over-investment in non-productive assets.

Another factor which pressed East Asian countries into financial crisis is the high level of companies' debt. Indonesia, as one of the worst countries hit by the crisis for example, had total external debt of \$131.7 billion or the same as almost 160% of its GDP in 1997 (Johnson 1998). More than half of the debt (\$66.3 billion) was attributed to the private sector.

As has been discussed above, ownership concentration more likely happens in countries with poor corporate governance. This paper is intended to examine firstly the level of ownership concentration in Indonesian listed companies. Second, it examines the impact of the ownership concentration on firms' performance. Finally, it aims to test whether ownership concentration has significant impact on the level of corporate debt. The reason why it does or does not will also be found in this paper.

Corporate Governance has become an interesting object for research by many researchers. The World Bank in particular has sponsored a lot of research involving many different countries since the early 1990s.

The research on the relationship between ownership structure and corporate performance started in 1932 when Berle and Means (Claessens et. al. 1999) came to a conclusion that the more concentrated ownership can consequently lead to better performance. They argued that diffusely held ownership might change the nature of the relationship between ownership and management and lead the management to pursue their own interest at shareholders' expenses. Research by Jensen and Meckling in 1976 and Shleifer and Vishny in 1986 (Claessens et. al. 1999) also found that ownership concentration has a positive impact on corporate value. They all show that ownership concentration can reduce the transaction costs in negotiating with all company's stakeholders, and lead to better monitoring of managers. On the other hand, the ownership diffusion may lead to increasing power in the hands of managers which in turn may not cohere with the shareholders' interest.

The concentrated ownership certainly will minimize agency costs -- i.e. the costs to manage conflicts between managers and shareholders. Kojima (1997) pointed out that these costs include the cost of monitoring and bonding management and the efficiency losses that are incurred as the conflicts of interest can not be resolved perfectly. Ownership concentration can reduce the agency cost as it will enable the large shareholder to assert control over the firm more easily and to limit inefficiency and

abuses by management (Alba, Claessens, and Djankov 1998).

Studies in the United States also found that there was a positive relation between ownership concentration and corporate value as it led to better monitoring management and in turn improve firm valuation.¹ Edwards and Fisher (1994) in investigating Cable's finding concluded that concentrated ownership led to improved firms' performance in Germany (Claessens, Djankov, Fan, and Lang 1999). For the emerging economies, Claessens (1996) and Claessens, Djankov and Polil (1996) undertook research for a cross-section of 706 firms over the 1991-95 period in the Czech Republic and concluded that the more concentrated ownership is, the higher the market valuation of a firm and the higher its profitability. Xu and Wang (1997) investigated over 500 Chinese listed companies in the period from 1993 to 1995 and found that there is a positive and significant correlation between ownership concentration and profitability.

A number of reasons have been highlighted on peculiar rationales of ownership concentration in transition economies. They are associated with the common features of transition economies such as weak legal protection of minority shareholders' interests and volatile economic environment (Shleifer and Vishny 1995; Demsetz and Lyhn 1984 in Xu and Wang 1997), weak law enforcement, unstable regulatory system and widespread corruption (Alba, Claessens, and

¹Research by Levy (1983), Lease, et. al. (1984), DeAngelo and DeAngelo (1985), Shleifer and Vishny (1986), McConnell and Servaes (1990), Holderness and Sheehan (1988), and Barclay and Holderness (1989) as cited by Claessens, Djankov, Fan, and Lang (1998).

Djankov, 1998), and where property rights are not well defined and/or protected and enforced by judicial systems (Shleifer and Vishny, 1997 in Claessens et. al. 1999). In countries with legal frameworks that do not work well, ownership concentration can be used as a means for shareholders to ensure that management behave on shareholders' interest. Specifically, those rationale behind the ownership concentration in transition economies have been summarized by Xu and Wang (1997) as follows:

- A weak and less sophisticated legal system and enforcement mechanism, where courts are less equipped to meddle with corporate affairs, and the interest of minority shareholders might not be well protected.
- A weak and less developed regulatory system. Regulation on antitrust, on insider trading, on non bank financial institutions may not be in place, or may not be rigorously enforced.
- A less developed equity market and noisy prices. The market capitalization of the emerging equity market is usually small and trading is noisy -- there are many speculators and few long term investors. The information content of the stock prices is limited. Equity markets in these countries are usually illiquid, making hostile takeovers almost impossible.
- A more volatile economic environment and imperfect product/factor markets. The market systems are newly established and may not function very well. The indirect measures of monitor and control, such as the market for managers, and the bankruptcy mech-

anism in the product market (not to mention takeover market), may not be functioning. Thus, direct measures of monitor and control, such as majority ownership and control of the board, are much needed.

Nonetheless, a very concentrated ownership could create some potential costs. The first is that conflict between large and small shareholder might lead the large shareholders to exploit their position to the expense of minority share holders (Shleifer and Vishny, 1997 and La Porta et. al. 1999 in Claessens et. al. 1999). It is also likely to lead to increasing risk taking behaviour (Alba, Claessens, and Djankov 1998). Empirical studies suggested that ownership concentration especially with families which also control interests in banks could lead to the possibility of easy borrowing which will increase the company's leverage as the case in Thailand (Alba, Claessens and Djankov 1998). The ownership concentration might also reduce market valuation. Several researches on corporate governance in Japan suggested that *keiretsu* affiliation, along with inefficiencies, has violated market valuation². Meanwhile, Alba, Claessens and Djankov (1998) in examining the listed companies in Thailand in 1992 and 1996 concluded that firms with concentrated ownership show a deteriorating performance relative to firms with less concentration.

The following part presents the descriptive analysis about the development of Indonesian capital market and corporate governance practices in Indonesia. It is then

²Aoiki, 1990; Prowse, 1992; Hoshi, Kashyap, and Scharfstein, 1991; and Kaplan, 1994 as cited by Claessens, Djankov, Fan, and Lang (1999).

followed by an explanation about the empirical evidence on ownership concentration and the impact on firms' performance and firms' debt in listed companies in Indonesia. Some recommendations will be presented at the final part of the paper.

Corporate Governance Practices in Listed Companies in Indonesia

Development of Stock Market in Indonesia

The history of the stock market in Indonesia dated back to the 1945 pre-independence era. In 1912 the Dutch colonial government set up *Vereeniging voor den Effecten Handel* (the Association for the Trading of Stock). Up to 1925, there had been three stock exchanges in Jakarta, Surabaya and Semarang. They had successfully attracted investors and actively traded government bonds and corporate securities of big companies, especially plantations owned by the Dutch. In 1952 President Soekarno declared the Emergency Bill to re-open Stock Exchange in Indonesia. However, no further actions were taken to operate the bill. The Indonesian-Netherlands conflict over West Papua (Irian Jaya) territory and the government policy to nationalize Dutch properties led to the termination of stock market activities until 1977.³

The government established the Jakarta Stock Exchange as well as BAPEPAM (Stock Exchange Executive Agency, later changed

into Stock Exchange Supervisory Board) and PT DANAREKSA (a national investment trust) in 1977. However, up to the end of 1988 its performance was very poor. As shown in Table 1, three years after the re-opening in 1980, there were only 3 listed companies listed in the exchange and it increased to 23 companies in 1983. The performance continued to be poor with only one new companies listed in 1984. Even, between 1985-1988 the exchange became idle with no more new listed companies. At the end of 1988 there were only 24 listed companies with only US\$253 million of market capitalization.

Many factors had been pointed out as the cause of the idleness of the capital market during the 1977-1987 period. One factor is that PT DANAREKSA, by presidential decree, had the right to buy shares at the first time up to 50% and sell them, plus the policy of limiting share's prices fluctuation to 4% maximum per day had eliminated the "normal" function of stock exchange as an institutions for speculation (Sjahrir 1995). Meanwhile, Djalil (1994) indicated that the primary goal of the stock market reopening which was to transfer corporate ownership from foreign owner to *pribumi* (indigenous people) had undermined the function of mobilizing and allocating capital. Furthermore, he specified that heavy government intervention and the highly regulated economy, including the abundance of subsidized credit had led to the distortion in the economy and the reliance of capital needs on debt. It was exacerbated by the slowing in economic growth.

1989-1990 was a period of remarkable growth in the Jakarta Stock Exchange performance. As shown in Table 1, the number

³see Sofyan Abdul Djalil. *Factors Affecting The Development of The Jakarta Stock Exchange, 1997-1990*. Diss. Tufts U, 1993. Ann Arbor: UMI, 1994. and Sjahrir, *Analisis Bursa Efek*, Jakarta: PT Gramedia Pustaka Utama, 1995.

Table 1

SUMMARY PERFORMANCE OF JAKARTA STOCK EXCHANGE

YEAR	TOTAL NUMBER OF LISTED COMPANIES	GROWTH	MARKET CAPITALIZATION (US\$ MILLION)	GROWTH
1977	1		8	
1978	0	-100.00%	5	-37.50%
1979	3		45	800.00%
1980	6	100.00%	63	40.00%
1981	8	33.33%	74	17.46%
1982	14	75.00%	144	94.59%
1983	23	64.29%	101	-29.86%
1984	24	4.35%	85	-15.84%
1985	24	0.00%	117	37.65%
1986	24	0.00%	81	-30.77%
1987	24	0.00%	68	-16.05%
1988	24	0.00%	253	272.06%
1989	57	137.50%	2,254	790.91%
1990	125	119.30%	8,081	258.52%
1991	141	12.80%	6,823	-15.57%
1992	155	9.93%	12,038	76.43%
1993	174	12.26%	32,953	173.74%
1994	216	24.14%	47,241	43.36%
1995	237	9.72%	66,585	40.95%

Source: Djalil (1993) for the 1977-1985 period and Indonesian Capital Market Directory 1996 for the 1986-1995 period.

of listing companies in the end of 1989 was 57 companies or 2.38 times of that in 1988. This remarkable increase continued in 1990, so the number of listing companies reached 125 companies. The market capitalization increased to almost 800% in 1989 and more than 250% in 1990, i.e. from US\$253 million in 1988 to US\$2.3 billion in 1989 and to US\$8.1 billion in 1990.

A series of financial deregulation undertaken by government has become the main explanation of the resurgence of capital market during 1989-1990 period. As has been highlighted by Djalil (1994), the securities market reform in 1987-1988 which included

securities regulation change from merit to disclosure system, abolishing direct government intervention in the market, and redirection of the JSE to achieving only economic objectives, had led to major increase in market activities. In addition, the liberalization of economic policies had led to the better allocation of resources and opened more investment opportunities and increased economic growth.

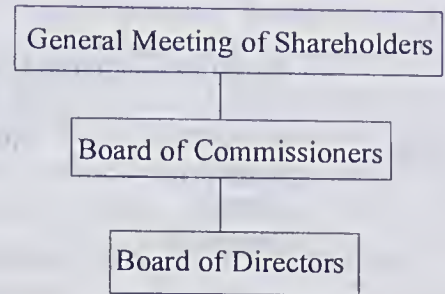
As such, the rapid growth in 1989-1990 was not sustained in the years ahead. Table 1 shows that since 1991 there is no more remarkable growth either in the number of new listed companies or the market capital-

ization. Furthermore, up to 1996 the participation of local investors in the market activities was still very low. According to Ary Suta, the Chairman of BAPEPAM, there were only 400 thousands local investors or only 0.2% of total Indonesian population actively involved in Indonesian stock exchange trading, whilst there were 37.1 million middle class in Indonesia (*Warta Ekonomi*, 24 June 1996).

As discussed in *Warta Ekonomi* (24 June 1996), the possible precipitating factors are: (1) the volatility of share prices, such as Bank Duta's share which was sold at Rp8,000 but then only be traded at Rp1,300 level; (2) the increasing number of internal acquisition of companies in the same group, 14 of 20 cases in 1995, which will increase capital gain only for the founders, especially in the case of the acquired companies which are unlisted companies; and (3) the weak enforcement of full disclosure regulation, which can be used by insider trading for their own benefit. Those could happen because, as been discussed by Djalil (1993), the package of 1987-88 reform had stressed too much to the promotional aspect of the market and put less attention on the prudential aspect.

Organizational Structure

According to New Indonesian Company Law (Law No. 1/1995), a company is a separate legal entity to which the directors (*direksi*) and commissioners (*komisaris*) represent the company and not the shareholders and they own a loyalty both above their own personal interests and the interests of the shareholders. The general structure of a listed company in Indonesia is as follows:



General Meeting of Shareholders (GMS) is the most powerful organ in a company. It is equipped with all authorities which are not granted to the directors or the commissioners within the limits determined by the Company Law and/or the Article of Association. GMS consists of annual GMS and other GMSs (Article 65.1). The annual GMS is held by the directors (Article 66.1) at the latest six months after the financial year (Article 65.2). Other GMSs might be held at any time along with the interest of the company (Article 65.4). The other GMSs might also be held at the request of one or more shareholders which represent 1/10 of total shares with valid voting rights, or at a lesser number as determined by the Article of Association (Article 66.2).

The GMS has the exclusive authorities: that is, to approve or to disapprove the following actions:

- amendment to the Articles of Association (Article 14);
- an increase or reduction in capital (Article 37);
- a consolidation, a merger, an acquisition, bankruptcy, and dissolution of the company (Article 76, 105, 114, 115.2);
- transfer of or placing the company's assets (all or substantial part) as security (Article 88.3);
- the extension of the company's term (Article 116.2);

- appointment and dismissal of directors and commissioners (Article 80, 91, 92);
- the annual report which is prepared by the directors (Article 60).

Directors is the company's organ which is fully responsible for the management of the company for the interest and objectives of the company and represents the company both in and out of court in compliance with the provisions of the Articles of Association (Article 1.4; 79.1; and 82). The minimum number of directors for listed companies is two (Article 79.2).

Each Direksi member shall be fully and personally liable, if the person concerned is at fault or neglects to performs his tasks in good faith and with a full sense of responsibility for the interest and business of the company. In the event that a bankruptcy occurs due to the fault of failure of the directors and the company's assets are not sufficient to cover the losses as a result of the bankruptcy, every member of the directors shall jointly and severally be liable for the losses.

Even though there was an increasing number of professionals in the director position, the majority of directors in Indonesian listed companies are still posed by family members of the biggest shareholders (usually also the founders) of the company. Research by Claessens, Djankov, and Lang (1999) found that fourfifths or more of companies in Indonesia have managers who belong to the controlling group.

Commisioners is the company's organ which has task of carrying out supervision of both a general and/or specific nature, as well as for giving advice to the directors in

running the company. The minimum number of commissioners for listed companies is two (Article 79.2). Commissioners are liable in the event that the annual account documents that are made available turn out to be incorrect and/or misleading. They should be discharged from the liability if it is proved that the situation was not their fault.

The board of commissioners is usually chaired by the founder of the company and the members consists of the major shareholders. It is also common that the company give a commissioner position to a person that pose a strong influence to the policy maker in government, such as retired minister, top official in the government or retired general in the army.

As the majority of companies in Indonesia are still young (they mostly emerged just after 1970s) they have common characteristics in the organizational behaviour. These characteristics that include strategy, flow of capital and power are centered to the owner and/or top management. There is a tendency of personalization of issues into the leader; and the daily operations and the future of the company are likely to be highly dependent on the founder.

As the major players in listed companies in Indonesia are overseas Chinese Indonesian firms, their common features also apply in Indonesian listed companies in general. They are as follows:

- Centralized decision making by a dominant chief executive who is also an owner.
- A paternalistic view of human resources of power and of mutual vertical obligations.
- A relatively low level of formal system, structure and procedure, but an intense concentration on efficiency in the firm's

main function. Few support staff or non-line functions.

- Weakness in incorporating complex activities which require extensive professionalization, decentralization of decision power and sophisticated coordination, as in successful brand marketing internationally.
- A tendency to see business as deal making and opportunism.
- The use of networks of external relations in pursuit of business opportunities, reliable information and capital. Not legalistic in approach; interpersonal trust is very important.
- Able to respond rapidly to opportunity
- Highly sensitive to the efficient use of capital, for example a high inventory turnover, careful debt management, an astute use of borrowing.
- Often linked into a network of stable supplier and customer relations and concentrated on one component of a total system, especially in manufacturing. (*Management in Asia Pacific*, 1996)

Ownership and Control

In a society which is highly obsessed with control issue like Indonesia, ownership concentration is an important means to control a company. Compared to other transition economies, the ownership concentration in Indonesia is very high. In 1995, the five biggest shareholders held 68.96% of outstanding shares in Indonesian listed companies. The five biggest shareholders in China in 1995 held 58.1 % of total listed companies' share, while in the Czech Republic the figure is 57.8% (Xu and Wang 1997).

Research by Claessens, Djankov, and Lang (1999) also suggested that corporations in Indonesia is mainly family-controlled. Indonesia has on average more than four companies controlled by a single family, the largest in East Asia. They also found that the largest ten families in Indonesia control half of the corporate sector (in terms of market capitalization). Furthermore, they found that 67.1% of Indonesian publicly listed companies in family hands, and only 0.6% are directly widely-held.

Minority Shareholders Protection

The Law No. 1/1995 has attempted to place special emphasis on the protection of minority shareholder rights. The law stated that every single shareholder has the rights:

- to lodge an actions against the company before the district court if a shareholder is harmed by certain actions of the company as a result of decisions by GMS, directors or commisioners (Article 54.2);
- to demand that the company buys their shares at a reasonable price, if they disagree with company's decision in the case of amendment of Articles of Associations, transfer of or placing the company's assets (all or substantial part) as security, and a consolidation, a merger, an acquisition (Article 55. 1).

In addition, shareholders which represent at least one-tenth of the total number of shares with valid voting rights have the right:

- to convene a GMS by request, other than a GMS convened by the directors (Article 66.2);
- to lodge an action at the District Court on behalf of the company against a director member (Article 85.3) or a cominis-

- sioner (Article 98.2) who, because of their mistake or negligence, has caused losses to the company;
- to request that an examination of the company be carried out in the event that there are suspicions that the company or members of directors and commissioners have committed acts contrary to law (Article 110.3);
 - to apply for the dissolution of the company to the District Court (Article 117.1).

However, using certain indicators, Prowse et. al. (1997 and 1998) in Alba, Claessens, and Djankov (1998) concluded that the degree of investor protection in Indonesia is the lowest in South East Asia with the score of 2, lower than Thailand (3), the Philippines and Malaysia (4). They give the maximum score of 6 if: (1) shareholder are allowed to vote by mail; (2) shareholders are not required to deposit their shares with the company or a financial intermediary before a shareholders' meeting; (3) cumulative voting is allowed; (4) when the minimum percentage of share capital required to call a meeting is less than 10%; (5) an oppressed minority mechanism is in place; and, (6) when legislation mandates one vote per share for all shares (or equivalent).

The weakness of law enforcement is another problem in applying the statutory law in Indonesia. The slow process in the courts, the competency of the judges in interpreting the business judgement, as well as the reliability and the fairness of the courts have become notorious sources of disappointment for business people and their lawyers for many years. As been cited by Green (1999):

Observers have described the Indonesian judicial systems as being: 'ill-equipped to deal with commercial matters particularly

those with international dimensions' (Trubek et. al. 1994), 'inefficient and slow' (Della-Giacoma 1995), 'capricious and unreliable' (Coudert Brothers, 1998), and as being to 'subject to intimidation from the executive branch of government' (Sreenivasan 1995)....

The court are overburdened and understaffed; there is little specialisation, with all types of cases going to general courts and judges; ... and there is a lack of confidence in the fairness of the trial process (Della-Giacoma 1995).

For this judicial enforcement indicator, Prowse et. al. (1997 and 1998) in Alba, Claessens, and Djankov (1998) gave the score of 4.4 to Indonesia. It is just above the Philippines (4.1) and much lower than Thailand (5.9) and Malaysia (7.7). With the maximum score of 10, they measure: (1) the efficiency of judicial system; (2) rule of law; (3) corruption; (4) risk of expropriation; and (5) risk of contract repudiation.

Financing Structure

Historically, the average companies in Indonesia were set up firstly by using family saving or by family collaboration as initial capital. Another way is by setting up joint venture with friends. Once the business develops, the company may go to bank to expand their business further. At this stage, the reputation and connection are more important rather than merely the rationality of business plan. It is also common thing that the big businesses set up their own bank due to financial sector deregulation taken by the government since 1983 followed by further reforms in which in October 1988 the government issue a decree to allow a company to establish a new bank with the capital

requirement of only Rp10 billion or about US\$5.8 million.

As has been explained in section 2. 1, the capital market in Indonesia that had been reopened in 1977 just emerged in 1989. Therefore, it was not surprising if in 1996 the business environment in Indonesia are still rely heavily on bank. In average, 53% assets of Indonesian listed companies in 1996 was financed from the debt, while only 29% of their shares are publicly traded in the stock market.

As in the case of Thailand, Indonesian companies may continue to rely more on banks in the years ahead. As has been pointed out by Alba, Claessens, and Djankov (1998), banks are relatively well developed, are closer to enterprises, as they have more information than capital markets do, whilst capital markets depend on corporate law, civil code, and institutions such as courts that has been well developed in Indonesia. In addition, to build a well-functioned stock market required a number of civil society components. It requires well-functioned regulators with self-governing bodies custodial as well as strong merchant banks with industry standards coordination. It requires well-functioned surveying and valuing firms, accounting firms, directors, and company secretaryship in which they need a well support from professional bodies, education systems, as well as institute of directors and role norms. Finally it requires free and fair media as public information sources.⁴

In the Indonesian legal framework, the interest of creditors is relatively secure. Using certain indicators, Prowse et. al. (1997 and 1998) in Alba, Claessens, and Djankov (1998) gave the maximum score of 4 in creditor protection indicator. It means Indonesia together with Malaysia gives a higher degree of protection to creditors compared to other South East Asian countries such as Thailand (score of 3) and Philippines (score of 0). Prowse et. al. give the maximum score of 4 to countries if: (1) there are minimum restrictions, e.g. creditors' consent, for firms to file for reorganization; (2) there is no automatic stay on collateral; (3) debtor loses control of the firm during a reorganisation; and, (4) secured creditors are given priority during a reorganisation.

Ownership Concentration, Firm's Performance and Firm's Debt

Using data of 237 listed companies in Indonesia for the 1995 fiscal year, the researcher firstly, regressed the ownership concentration to firms' performance, and then to firms' debt. Listed companies were chosen as the sample for all Indonesian firms, for the reason of data availability. The result is that the ownership concentration has a positive and significant effect both on the firms' performance and firms' debt.

Data Description and Definitions of Variables

Most data required for this research, such as Net Sales/Revenues (SALE), Leverage Ratio (LEVR), Price Earning Ratio (PER), Price to Book Ratio (PBV), Return on Equity (ROE), and Return on Assets (ROA) were taken directly from the Indonesian Cap-

⁴Cited from Course Notes on *Future Challenges for Management in The Asia Pacific*, by Gordon Redding at MBA Program, The Australian National University, Canberra, March 1999.

ital Market Directory 1996, composed by ECFIN. The author computed the data which are not provided by ECFIN: i.e., growth (GROW), concentration ratio (C5), and Herfindahl index (HERF).

To measure the impact of ownership concentration on firms performance (FP) the researcher use model which is similar to Xu and Wang model (1997) as follows:

$$FP = \sum_{i=1}^9 \beta_1 DUM_i + \beta_2 SALE + \beta_3 LEVR + \beta_4 GROW + \beta_5 C5 + e ; \text{ and}$$

$$FP = \sum_{i=1}^9 \beta_1 DUM_i + \beta_2 SALE + \beta_3 LEVR + \beta_4 GROW + \beta_5 HERF + e$$

As indicator of firm's performance (FP), the author employed both market value ratios and profitability (or efficiency) ratios. For the market value ratios, the Price-Earnings ratio (PER) and Price to Book Value ratio (PBV) were employed, whereas for the profitability or efficiency ratios, the writer employed Return on Total Assets (ROA) and Return on Equity (ROE) ratios.

For the ownership concentration parameter, the author used the percentage of shares owned by the five biggest shareholders (C5) and Herfindahl index of ownership concentration (HERF). The model also incorporated factors other than ownership concentration which might affect the firm's performance, that is net sales/revenues (SALE), leverage ratio (LEVR), and company's growth (GROW). The regression analysis also distinguished the differences in the industrial sectors by employing the sector dummies.

The definition of each independent variable is as follows:

- DUM_i : i = 1, 2, ... 9, for Agricultural Production, Animal Husbandry, Bank ing/Credit Agencies Other than Banks/Insurances/Real Estate, Hotel/Travel Services, Manufac- turing, Mining/Mining Services, Telecommunication, Transporta- tion Services, and Whole Sale and Retail Trade. If dij is the element of DUM_i, d_{ij} = 1 if firm j is in in- dustry I and d_{ij} = 0 otherwise;
- SALE : Net Sales/Revenues acquired by companies;
- LEVR : Leverage ratio or total debt divided by total equity;
- GROW : Profit before tax at current year di- vided by profit before tax at year before;
- C5 : Percentage of shares owned by the five biggest shareholders;
- HERF : Herfindahl index of ownership con- centration or the sum of squared percentage of shares owned by each five biggest shareholders.

Meanwhile, the following are the defini- tion of the dependent variables:

- PER : Price Earning Ratio or closing share price at the end of financial statement period divided by earn ings per share;
- PBV : Price Book Value or closing share price at the end of period divided by equity per share;
- ROE : Return on Equity or after tax pro- fits divided by the book value of equity;
- ROA : Return on Assets or after tax pro- fits divided by the book value of total assets.

To measure the impact of ownership concentration on firms' debt (LEVR), the following model are used

$$LEVR = \sum_{i=1}^9 \beta_1 DUM_i + \beta_2 C5 + e ; \text{ and}$$
$$LEVR = \sum_{i=1}^9 \beta_1 DUM_i + \beta_2 HERF + e$$

As independent variables are ownership concentration with incorporated the differences in industrial sector. The definition of independent variables is as follows:

- DUM : i = 1, 2, ... 9, for Agricultural Production, Animal Husbandry, Bank ing/Credit Agencies Other than Banks/Insurances/Real Estate, Hotel/Travel Services, Manufacturing, Mining/Mining Services, Telecommunication, Transportation Services, and Whole Sale and Retail Trade. If dij is the element of DUMi, dij = 1 if firm j is in industry i and dij = 0 otherwise;
- C5 : Percentage of shares owned by the five biggest shareholders
- HERF : Herfindahl index of ownership concentration or the sum of squared percentage of shares owned by each five biggest shareholders.

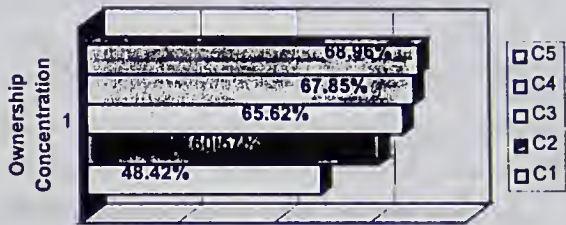
The dependent variable is Leverage ratio (LEVR) which is defined as total debt divided by total equity.

Ownership Concentration and Firms' Performance

Referring to Figure 1, ownership in Indonesian listed companies is very highly concentrated. Almost half of shares (48.42%) are only held by one shareholder. The five biggest shareholders hold up to 68.96% of ownership. Appendix 1 shows that sectors

(other than Other Industry which is only one firm) which have the highest concentration are Mining (74.78%), followed by Banking (70.82%) and Agricultural Production (69.34%), whereas Transportation Services has the lowest ownership concentration of 55.14%.

Figure 1
OWNERSHIP CONCENTRATION IN
INDONESIAN LISTED COMPANIES IN 1995



The researcher attempted to include PER as a measurement of firms' performance. However, it is found that there is no significant correlation between ownership concentration (as well as other factors) on PER. As shown in the Table 2, there is no individual variable which has significant impact on PER at 10% level. Even so, the F value of the model is not significant at 20% level, meaning that the model is not good for prediction of PER.

As PER means the price that investors are prepared to pay for each money value of earnings, it might be concluded that there is no relation between this price with all independent variables in the model.⁵

⁵Sjahir (1995) in a research on Jakarta Stock Exchange during January 1987 to April 1990 concluded that there is no significant impact of Dividend Yield (DY), Book Value (BV), Earning Per Share, Growth (GR), Standard Deviation of Profit on each companies (SD) and Closing Price (CP) on Price Earning Ratio (PER).

Table 2

REGRESSION ANALYSIS OF OWNERSHIP CONCENTRATION AND FIRM'S PERFORMANCE

	DUM	LN_SALE	LEVR	GROW	C5	HERF	Adj.R ²	F
PER	Yes	-1.368 ^e (-0.78)	-3.576 ^e (-0.32)	1.107 (1.78)	-0.045 ^d (-0.34)		-0.017	0.689 ^e
	Yes	-1.359 ^e (-0.77)	-3.506 ^e (-0.32)	1.11 ^c (1.79)		-0.0006 ^d (-0.53)	-0.017	0.703 ^e
PBV	Yes	0.324 ^a (4.24)	-0.213 ^e (-0.44)	-0.107 ^a (-3.96)	0.008 ^d (1.45)		0.111	3.278 ^a
	Yes	0.322 ^a (4.23)	-0.217 ^e (-0.46)	-0.107 ^a (-3.99)		0.0001 ^b (2.04)	0.12	3.465 ^a
ROE	Yes	1.921 ^a (2.80)	-4.499 ^e (-1.05)	3.870 ^a (16.01)	-0.040 ^e (0.77)		0.573	25.331
	Yes	1.949 ^a (2.91)	-5.221 ^e (-1.25)	3.843 ^a (16.28)		0.0015 ^a (3.34)	0.592	27.341 ^a
ROA	Yes	1.317 ^a (3.33)	-16.261 ^a (-6.57)	0.286 ^b (2.06)	0.043 ^d (1.45)		0.233	6.519 ^a
	Yes	1.317 ^a (3.40)	-16.486 ^a (-6.79)	0.277 ^b (2.03)		0.0008 ^a (3.21)	0.26	7.379 ^a

Note: *t-statistics are in parentheses
 **a,b,c,d,e: significant at 1%, 5%, 10% and not significant at 20% level respectively.

Table 2 shows that ownership concentration (using Herfindhal index variable) significantly has a positive impact on PBV, ROE and ROA. This finding coheres with the findings by Xu and Wang (1997) in China, and by Claessens (1996) and Claessens, Djankov and Pohl (1996) in the Czech Republic. Therefore, it can be concluded that ownership concentration contributed positively on firms' performance in Indonesian listed companies.

The main reason as has been discussed in Section 1.2 might be that the ownership concentration could reduce the transaction costs in negotiating with all company's stakeholders, and that the ownership concentration enables the owner to monitor the managers better. Both factors clearly in turn

will increase firms' performance. In addition, in transition economies like Indonesia, where the legal system is quite weak, the ownership concentration is a primary means for the owner to discipline managers and to ensure that managers behave in shareholders' interest.

Table 2 above also shows that "sale" has a positive and significant effect on PBV. It is a rational consideration that when buying a share, the buyer takes into consideration the company's sale/revenues factors in their decision. The empirical evidence that sale has a positive and significant impact on ROE and ROA also clearly could be explained that as sale is the main contributor for profit element, therefore the higher the sale will lead to the higher ROE and ROA.

In above regression, "growth" has positive and significant effect on ROE and ROA. Similar to the explanation on the effect of sale on ROE and ROA, "growth" variable which derived from profit before tax at current year and year before will clearly have positive relation with ROE and ROA variables which also consist of profit element. Interestingly, Table 2 above shows that growth significantly has a negative impact on PBV. The rational decision of buying share is that the buyer will agree to pay a share at higher price if the company grows faster than others do. This might suggest that investors in Indonesia did not take the historic company's growth into their consideration of buying shares. The decisions might be more affected by "emotional" factors, such as positive sentiment that the price will increase in the future.

Another interesting finding is that in Indonesian listed companies, leverage significantly has a negative impact on ROA. According to the theories in financial management, up to the optimum level of debt, debt will improve the companies performance as it inherits tax shield (the "gain" from interest payment which is tax deductible). However, as a company borrows more, the cost of financial distress (occurred when promises to creditors are broken or honoured with difficulty) will increase, which also lead the creditor to demand more compensation in advance in the form of higher interest rate.⁶ Therefore, the finding might suggest that on the average, the level of debt in Indonesian listed companies had ex-

ceeded the optimum level and led to diminishing firms' performance.

Ownership Concentration and Firms' Debt

As shown in data summary in the Appendix, Indonesian listed companies in 1995 were very highly leveraged. More than half (53%) of the assets of all Indonesian listed companies was financed from debt. Financial/Real Estate sector has the highest leverage ratio, i.e. 67%, followed by Whole Sale and Retail Trade of 63%. Meanwhile, sectors which have least leverage are telecommunication sector (32%) and Hotel/Travel Services sector (34%). This variance follows the principal theory of capital structure (Brealey and Myers 1996) where companies with safe, plenty of tangible assets and taxable income to shield out (as in the case of financial services and real estate) might rely heavily on debt, whereas unprofitable companies with risky, intangible assets should rely primarily on equity financing (such as hotel/tourism industries).

On the other side, the proportion of shares traded in stock market was relatively small. On average only 28.64% of outstanding shares of Indonesian listed companies was owned by public. However, the deviation is very large as one company traded 93.42% of its shares in stock exchange (PT Zebra Nusantara), while on the other side one company only listed 4.80% of its shares (PT Texmaco Perkasa Engineering).

This fact could be interpreted that Indonesian firms still depended heavily on bank financing rather than capital market financing. As has been discussed in Section 2.4 the relatively well developed banking sector compared to the less sophisticated stock

⁶see, Brealey, Richard A and Myers, Stewart C, 1996, *Principles of Corporate Finance*, Fifth edition, The McGrawHill Companies, Inc., Chapter 18 of How Much Should a Firm Borrow?

market sector might be the main cause of this fact. The weak investor protection and low judicial enforcement in Indonesia compared to the relatively strong creditor protection might be factors that underpin the preference.

Regression of ownership concentration on leverage ratio as shown in Table 3 indicates that there is a significant and positive impact of ownership concentration on leverage ratio. Regression of Concentration of top five shareholders (C5) on Log normal of Leverage Ratio (LN~LEVR) is positive and significant at 10% level. This is consistent with the research by Alba, Claessens and Djankov (1998) in listed companies in Thailand.

The fact that more than 40% control of companies in Indonesia is in family hands (Claessens, Djankov, and Lang 1999) -- who are also likely controlling majority shares in the banks and other financial institutions might be the cause of the positive correlation -- between ownership concentration and firms' debt. This is also the case in Thailand as has been pointed out by Alba,

Claessens and Djankov (1998) that the consequence of ownership concentration in family hands that have controlling interests in banks, is the possibility of easy borrowing and the increase in leverage.

Conclusions

Many factors underlining the business environment had led to high ownership concentration in Indonesia. They include the basic characteristics of the society, the weakness in investor protection and in judicial enforcement, the less equipped legal framework in dealing with commercial issues, and the less developed stock market instruments. In this environment, ownership concentration is a means to ensure that the managers behave in the best interests of shareholder.

Another characteristic of Indonesian listed companies is their heavy reliance on bank financing. The reasons behind the fact are the financial sector liberalizations undertaken by the government since 1983, the relatively well developed banking sector, and the relatively strong protection on creditors' interest. On the contrary, the proportion of public share over listed companies in Indonesia is still very small. The new entrance of stock market instruments in Indonesia as well as the low protection of minority shareholders' interest might be attributed to the tendency.

In empirical evidence, it is found that ownership concentration had contributed positively to performance of listed companies in Indonesia in 1995. Likewise, the ownership concentration had led to the increase of firms' debt. On the other hand, it is also found that the increasing debt had decreased corporate performance. It might be suggested that this very concentrated owner-

Table 3

REGRESSION ANALYSIS OF OWNERSHIP CONCENTRATION AND FIRMS' DEBT

	DUM	C5	HERF	Adj.R ²	F
LN~LEVR	Yes	0.0042 ^c (1.67)		0.095	3.485 ^a
	Yes		0.0638 ^d (1.33)	0.091	3.389 ^a

Note: * t-statistics are in parentheses

** a,b,c,d,e: significant at 1%, 5%, 10% and 20% level respectively

ship had lead to excessive borrowing behaviour, which in turn had deteriorated the corporate performance. Therefore, to ensure that the ownership concentration will lead to better firms' performance, which in this case also means protecting the interest of minority shareholders, good corporate governance practices should be established and enforced.

However, based on the peculiar characteristics of Indonesian society and the fact that certain degree of ownership concentration is beneficial for the company, it might be suggested that corporate restructuring should not attempt to break down this fundamental advantage, eg by attempting to disperse the company ownership very widely.

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	Net Sales/ Revenues (SALE)	Leverage Ratio (LEVR)	Company Growth (GROWTH)	Five Biggest Ownership Concentration (C5)	Herfindahl Index of C5 (HERF)	Price Equity Ratio (PER)	Price to Book Value Ratio (PBV)	Return on Equity (ROE)	Return on Assets (ROA)
ALL INDUSTRY									
Mean	427,139	0.53	0.11	68.96	3,043.21	14.93	1.35	10.77	5.09
Std. Deviation	1,036,030	0.22	3.24	14.38	1,681.43	28.83	1.34	17.32	7.44
AGRICULTURAL PRODUCTION									
Mean	498,707	0.55	0.02	69.34	3,792.24	7.10	0.87	13.66	6.33
Std Deviation	289,423	0.11	0.40	12.40	1,796.84	3.22	0.22	4.98	3.08
ANIMAL HUSBANDRY									
Mean	652,867	0.51	0.56	67.45	3,615.51	11.80	1.24	10.82	4.51
Std. Deviation	561,825	0.23	1.90	13.88	1,696.11	7.26	1.01	5.92	2.18
BANKING/CREDIT AGENCIES OTHER THAN BANKS/INSURANCES/REAL ESTATE									
Mean	328,563	0.67	0.73	70.82	2,859.92	10.64	1.13	12.36	2.71
Std. Deviation	462,353	0.25	2.02	12.77	1,604.97	10.79	0.71	5.92	9.74
HOTEL/TRAVEL SERVICES									
Mean	100,525	0.34	(0.25)	68.42	2,069.85	29.39	0.81	(1.84)	1.14
Std. Deviation	83,554	0.18	0.58	28.14	1,325.56	35.44	0.41	17.50	6.67
MANUFACTURING									
Mean	450,133	0.48	(0.22)	68.56	3,124.92	17.18	1.51	10.47	6.30
Std. Deviation	1,275,072	0.18	4.03	14.35	1,702.47	36.99	1.66	22.10	6.18
MINING/MINING SERVICES									
Mean	262,374	0.42	0.27	74.78	3,756.61	11.02	1.04	11.87	7.54
Std. Deviation	271,256	0.19	0.73	9.15	2,308.58	7.61	0.63	7.51	6.26
TELECOMMUNICATION									
Mean	3,074,982	0.32	0.27	65.00	4,225.00	17.08	2.15	18.99	14.32
Std. Deviation	2,870,977	0.30	0.21	-	-	2.31	0.37	9.50	12.19
TRANSPORTATION SERVICES									
Mean	70,633	0.36	0.34	55.14	2,307.22	12.92	0.93	11.21	6.88
Std. Deviation	49,713	0.22	0.62	25.76	2,414.12	12.12	0.50	7.57	4.44
WHOLE SALE AND RETAIL TRADE									
Mean	600,002	0.63	(0.45)	66.98	2,956.03	14.96	1.87	6.70	2.84
Std. Deviation	447,433	0.09	2.38	5.53	1,056.99	9.11	1.14	15.68	4.58
OTHER INDUSTRY									
1 Company	702,179	0.44	1.31	79.17	2,287.45	8.20	1.00	12.24	6.00

Japan's Economic Role in Asia

Domestic Recession, Regional Crisis, and the New Wave of Japan Bashing

Patrick Dwyer

JAPAN'S economy is indeed in bad shape. Books of the 1970s and 80s hailed and sought to explain Japan's phenomenal achievements (*MITI and the Japanese Miracle*) and today they deplore its failures (*Japan: The System that Soured*) and offer detailed prescriptions for the policy changes necessary for recovery (*Restoring Japan's Economic Growth*). Not at all surprisingly, Paul Krugman has been particularly harsh: "The state of Japan is a scandal, an outrage, a reproach ... Japan's economic officials have subtracted value from their nation and the world as a whole on a truly heroic scale" (Krugman).

Another observer proclaims "the extent of Japanese mismanagement of its economy in the last seven years is one of the overwhelming themes of the modern era" (*New York Times*, 17 December 1997). Economist Adam Posen vividly analogizes Japan's policy failures by describing it as a neighbor that was once productive and athletic and has gone to doing nothing but sitting in a lounge chair drinking beer and grilling sausages -- and believing that it is immune to the threat of a heart attack (Posen 1998, 143). Posen's argument is that Japan's troubles have been entirely avoidable and to blame on the poor policy choices of

Japan's inept bureaucrats. He claims Japan's condition is not one of a chronic illness that requires the dramatic measures of surgery (structural reform), but rather is due to simple laziness and ignorance--proper insight and motivation are all that are required to get things turned around. "The stagnation of Japan in the 1990s was anything but inevitable, and it was misguided austerity and financial laissez-faire -- not a lack of return on investment or political deadlock -- that caused it" (Posen 1998, 21).

It is inarguable that Japan is by far in the worst economic shape it has seen since its fantastic achievements following World War II. In 1992 it began a stretch of very low growth rates and in 1997 fell into outright recession. It is hard to argue against the claim that this has been "the most radical economic reversal suffered by any country since WW II" (MacIntyre 1999, 3). For the first time in recent history Japan's unemployment rate has risen above that of the United States. Recent reports claim that Japan achieved 1.9 percent growth in the first quarter of 1999, but most observers are highly skeptical that this is a valid sign for true optimism.

The severity of Japan's recession alone is of significant consequence for the world

economy. But this significance is profoundly compounded by the coincidence of Japan's recession occurring at the same time as the Asian financial crisis. These are two entirely separate and distinctly different problems, but their implications for each other are most important. The Asian crisis certainly had negative consequences for Japanese manufacturers, construction companies, and banks operating in the region, as well as Japanese companies that depend on Asia as an export market. However, the consequences of Japan's domestic economic troubles on Asia's recovery from the financial crisis are of much greater significance.

This is the primary reason why Japan has been subjected to this new wave of bashing. Japan's economy is much larger than the rest of Asia combined, and nearly eight times the size of the ASEAN-4's economies together (Indonesia, Malaysia, Thailand, and the Philippines). Japan is a primary investor and trading partner with all of the troubled economies, as well as a principal source of private financing and official development assistance. Due to the magnitude of the economic ties between Japan and Asia, it is widely held that Asia's full recovery is dependent on a healthy Japan.

While Japan's domestic economy exploded in the decades since WW II, so did its economic role in Asia. Through the early 1970s, Japan's main economic interaction with the outside world was through merchandise trade, which required little economic intimacy (Lincoln 1993, 57). Furthermore, Japan's focus was almost exclusively to the West. This was due to the rather uncomfortable relations with its Asian neighbors from the legacy of Japanese hostility in WW II in addition to the Cold War ne-

cessity of Japan's security alliance with the U.S. In the 1970s, trade frictions with the U.S. and the oil crisis in the Middle East provided new incentives for Japan to expand its involvement in Asia (Morley 1993, 5). In 1977 this new openness to the region was formalized with the Fukuda Doctrine when then Prime Minister Takeo Fukuda visited and pledged that Japan would "take actions reflecting its increasing responsibilities toward Southeast Asia" (Hatch and Yamamura 1996, 18). The greatest force pushing Japan into the region occurred with the Plaza Accord in 1985 when world leaders gathered in New York and agreed to revalue the major currencies against the dollar, including the yen. The resultant dramatic appreciation of the yen seriously wounded the international competitiveness of Japanese manufacturers exporting from Japan, and consequently Japanese foreign direct investment exploded. At first it was largely directed at the U.S. and other industrialized countries, but the government actively promoted the "vision of East and Southeast Asia as integral parts of a Greater Japan, critically important links in an expanded Japanese production and exporting alliance."

Today this vision has been realized. This rapid rise as a major international investor in the late 1980s transformed Japan's economic relationship with the world. "Becoming a large owner of foreign assets represented an epochal change for the nation, engaging it more intimately in the economic and political affairs of the outside world than at any point since the end of the war and arguably more than at any point in its previous history" (Lincoln 1993, 21). This economic embrace of the world, and of Asia in particular, profoundly affected both

Japan's view of the world, and the world's view of Japan. "The country that once generated hostility and suspicion today inspires respect and admiration in many parts of the region." This was not accidental nor extraordinary but rather "the product of deliberate, largely successful strategy to embrace the region in a complex web of personal, governmental, and corporate ties -- all united under the ubiquitous banner of *keizai kyoryoku*, or economic cooperation" (Hatch and Yamamura 1996, 115).

Japan's economic links to Asia continued to strengthen during the 1980s and early 1990s. This was led not only by private industry, but also by government encouragement and increased official aid and economic cooperation, particularly in Southeast Asia. The Miyazawa Doctrine extended the Fukuda Doctrine when in a visit to Bangkok in 1993, then Prime Minister Kiichi Miyazawa defined Japan's role in post-Cold War Asia as one of continued strong economic cooperation and assertion of greater Japanese political leadership in the region. The importance of these ties makes the coincidence of Japan's recession and the Asian financial crisis particularly unfortunate.

The economic significance of Japan to Asia today has been reiterated by innumerable economists, officials, and journalists. Most of these words have come in the form of direct attacks on Japan -- that they are not acting with sufficient purpose to solve their domestic problems in light of the consequences of such inaction on their Asian neighbors. The criticism has been led by former Secretary of the Treasury Robert Rubin who stated "A return of domestic, demand-led growth and confidence in Japan through appropriate policies could contri-

bute greatly to recovery in Japan's Asian neighbors, and Japan's failure to accomplish these objectives is a major impediment to Asia's recovery." (Rubin) His then deputy, Larry Summers, proclaimed "We cannot assume that the global economy will be able to fly permanently on a single engine. A global economy cannot be fully successful without a successful Japan" (Summers). U.S. Trade Representative Charlene Barshefsky attacked with "What is happening in Japan is hitting all of its neighbors and it is triggering a huge amount of instability around the world" (*New York Times*, 16 June 1998). Others are even more extreme, claiming that Japan's economic health is the primary condition for Asia's recovery: "The speed and extent of Japan's economic recovery are the most important determinants of the ability of East Asian economies to come out of the crisis" (Posen 1998, 1). The U.S. is certainly not alone in their concern, with the IMF, the OECD, and undoubtedly other organizations issuing statements criticizing Japan's inadequate response to its economic malaise, considering its global significance.

At least one attempt has been made to directly quantify the importance of Japan with the claim that for every one per cent increase in Japanese GDP growth, the crisis-hit East Asian economies will grow an additional 0.13 per cent on average (Nomura). This number, even if accurate, likely does not fully capture the importance of Japan to the region. Even many Japanese government reports acknowledge the consequences of their domestic economy for supporting Asia's recovery (JETRO; Nishibayashi). One Japanese commentator even went so far as to declare that "The question 'How can Japan support East Asia?' is tantamount to how Japan can support itself" (Tanaka 1998,

3). While in general most Japanese officials and observers are fully aware of their influence on the region, of course in addition to the importance of Asia to Japan, fewer seem to accept that their macroeconomic policies should be based on such concerns or that outsiders correctly understand their trouble. *Gaiatsu*, or foreign pressure, is often effective in swaying Japanese policy, and is even frequently manipulated by domestic parties to effect change when they do not have adequate influence to do so -- but for the most part the recent criticisms of Japan's economic policies have been rejected. One high-ranking Japanese diplomat's angry reaction was "The Americans are idiots -- they don't understand a thing" (*Far Eastern Economic Review*, 5 March 1998).

Japan's economic ties to Asia have expanded and become increasingly complex throughout Japan and Asia's development. Today, Japanese companies hold the greatest cumulative amount of foreign direct investment in the region and continue to be the largest source of the investment projects. Japan is a primary trading partner with the region, with Asia being a major market for Japanese products and Japan being highly dependent on Asia as a source of natural resources.

Furthermore, Japanese manufacturers in the region export a very large portion of their Asian production, contributing positively to the trade balances of these economies. Japanese banks provide an important source of capital to the region and were by far the most heavily exposed when the financial crisis-hit, accounting for 30 per cent of lending to the crisis-hit economies (Rajan 1998, 2). Japan is by far the largest source of official development assistance

(ODA) to the region. While many criticize the forms of Japanese aid (a self-interested commercial orientation and a high loan to grant ratio), the high volume of aid is undeniable.

Finally, in addition to direct economic links of investment, trade, finance, and development assistance, one cannot ignore the importance of currency relationships. As the appreciation of the yen with the Plaza Accord was a primary stimulus for increased Japanese investment in the region, recent depreciation of the yen has had important negative consequences. Japan's former vice finance minister, Eisuke Sakakibara, has even acknowledged that the yen's steep decline against the dollar in the spring of 1995 "sowed the seeds of crisis for Asian economies whose currencies were attached to the greenback" (*Jakarta Post*, 3 July 1999). Each of these facets will be examined in the perspective of how Japan's troubles have been relevant for Asia.

Foreign Direct Investment

As described above, Japan's economic embrace of Asia was dramatically strengthened as a consequence of the appreciation of the yen with the Plaza Accord in 1985. Previously, North America had been practically the sole target of Japanese investment (and is still the primary target), but in the 1980s there was a dramatic increase in interest in Asia. Japanese firms brought an enormous amount of investment to the region as they relocated much of their manufacturing overseas.

In addition, the appreciation of the yen made it more expensive for Japanese MNCs already in Asia to import parts from Japan, and thus they increased their purchases of locally produced parts and many Japanese

subcontractors moved to Asia as well -- obviously benefiting the local economies. "In this harsh new environment (of the strong yen), Japanese industry, particularly exporting industry, began to see the region as an extension of its home base" (Hatch and Yamamura 1996, 118).

Furthermore, this new wave of investment was different from what had come before. While Japan had long been involved in the extraction of raw materials from its southern neighbors, it now brought in manufacturing industries such as electronics and automobiles, which have a much greater potential for beneficial technology transfer. For the most part this investment was not attracted by the local consumer markets, but rather by the opportunity to develop a production base to export to the U.S., Europe, and back to Japan.

Japan is by far the largest single source of FDI in Asia. By early 1998, cumulative Japanese investments in Asia totaled \$111 billion, with 10,995 Japanese-owned companies employing 1.3 million people. Certainly the total contribution of Japanese companies to employment is many times greater, counting joint ventures, licensing agreements, sub-contractors, suppliers, and various support services. In 1994, Japanese firms employed 7% of Thailand's production workers and in Malaysia, a single Japanese company, Matsushita, accounted for nearly 4% of the entire country's GNP (Hatch and Yamamura 1996, 6).

The question of relevance here is how have the foreign direct investment patterns of Japanese companies been affected by Japan's domestic recession, and then by the Asian crisis? As described by the Japan External Trade Organization (JETRO), since

they "are of central importance to the economics of the region ... how Japanese manufacturers respond to the crisis will have a huge impact on their host economies" (JETRO 43). Of course many Japanese MNCs have suffered since its economy began to struggle in 1992 and new investments were limited to some degree. Japan's share of world FDI outflow (in U.S. dollars) fell dramatically from 16% in 1991 to 8.7% in 1992 to 5.7% in 1993 (JETRO 1). Japanese FDI (in yen) in ASEAN fell by 11.5% in 1991, 2.2% in 1992, and 33% in 1993. These declines in investment were clearly a consequence of the burst of Japan's "bubble" economy. However, this decline bottomed out in 1993 and has increased rapidly since (See Table I).

FDI outflows in the 1980s were certainly inflated by abundant liquidity in an overheated economy and "in a sense, therefore, the country is returning to its normal pattern of outward investment" (UNCTAD 1998, 157). The return to high rates of investment growth in Asia in 1994 was profound. In Thailand in 1994 Japanese firms accounted for 40% of all new investment proposals, with major projects to expand capacity by electronics firms (Casio and Sony) and automakers (Toyota and Honda) (Hatch and Yamamura 1996, 10). Japanese FDI in Asia likely recovered while the Japanese economy continued to suffer due to the fact that "depressed demand conditions at home may have induced Japanese companies to invest abroad as foreign investment seemed more profitable than domestic investment" (UNCTAD 1998, 157). Japanese manufacturers were particularly active in expanding their presence in Asia from 1993 due to the strong yen, confidence in emerging markets, and relaxed regulations and pre-

ferential treatment for FDI by Asian host economies (Nishibayashi 80).

Table 1

JAPANESE INVESTMENT IN ASEAN

Year	Amount*	Change
1990	4,761	28.2%
1991	4,214	-11.5%
1992	4,120	-2.2%
1993	2,760	-33.0%
1994	4,012	45.4%
1995	3,991	-0.5%
1996	5,575	39.7%
1997	6,989	25.4%

* 100 million yen

Source: Nishibayashi

Despite the very low domestic economic growth, Japan's investment in Asia was strong when the financial crisis hit in 1997. FDI was definitely much less volatile than portfolio capital flows and commercial lending, but nevertheless the consequence of any withdrawal or significant fall in new foreign investment would be great. FDI is of particular importance in Asia where it has gone from being 10% of total resource flows to the region in 1990 to 53% in 1997. "FDI has become the single most important source of private development financing for the region, and is likely to be particularly important for the economics affected by the crisis" (UNCTAD 1998, 198). FDI has indeed suffered, but not as much as one might have expected. Total FDI to East and Southeast Asia actually increased by 5% in 1997 with overall inflows to the five economics most affected by the crisis relat-

ively similar to 1996. There were moderate decreases in inflows to Indonesia, Malaysia, and the Philippines, no change to Korea, and sharp increase to Thailand (UNCTAD 1998, 197).

Of course some Japanese companies were forced to withdrawal or limit production activities, and new investment projects were certainly not what they would have been without the crisis, but there is no sign that these reactions were at all affected by Japan's domestic troubles. In yen terms, Japanese investment in Asia overall was up by 14.3% in fiscal year 1997 (April 1997 to March 1998) (although in dollar terms the increase was less remarkable due to the slide of the yen over 1996 and 1997) (Nishibayashi 1999). However, the vast majority of this occurred in the first half of the year, with only a marginal increase in investments to Asia in the second half of FY 1997. ASEAN countries experienced a fall of 10.9% in FDI in the second half of FY 1997 (Nishibayashi) and FDI continued to fall in 1998. Nevertheless, in many cases Japanese companies have demonstrated a much more concerted effort to maintain their presence in Asia than those from America or Europe, due to their long-term vision and their somewhat familial attachment to the region.

One survey determined that 62.9% of Japanese firms affected by the crisis said they would continue pursuing their current East Asian business strategies (JETRO 1999, 43). Another, undertaken in mid-1998, indicates that between 44% (Indonesia) and 75% (Philippines) of Japanese MNCs expected to increase their investments in Asia in the next one to three years (UNCTAD 1998, 235). Japanese firms ac-

counted for 86 of the 138 capital increases that took place between January 1997 and August 1998 in Thailand. In contrast, FDI from the U.S. fell by 50% in 1997 and there was a net withdrawal by U.S. firms in Thailand (JETRO 1999, 41).

Furthermore, official data underestimates Japanese total investment due to the fact that in recent years Japanese firms have drawn a large portion of their funds for new investment from local sources, either from profits or local debt markets (Terry 1998, 2). Many Japanese affiliates have coped by increasing local content ratios and shifting sales to exports. Some have even taken advantage of the opportunities offered by exchange rate depreciations, lower property prices, and more company assets up for sale to increase their investments. "With billions of dollars already invested in Southeast Asia, Japanese companies are not pulling out of the region. Instead, they are digging in deeper, buying bigger shares of cash-strapped venture partners, and ramping up exports to the rest of the world" (*Business Week*, 20 April 98). Of course, the situation is distinctly different between those companies that are export-oriented and those that are producing for local markets.

The crisis is "basically smooth sailing for the exporters ... if you look at it from a total profit perspective, we come out even," claims a Matsushita executive, Katsuro Sakakibara. The president and CEO of Canon, Fujio Miturai, is even more positive: "If there are pluses and minuses to the Asia crisis, for Canon, on balance it is a plus (Terry 1998, 1). What is good for Japanese companies invested in the region will eventually be beneficial to the host economies. Japanese automakers whose Asian produc-

tion was primarily oriented at local markets have not fared so well. Obviously there has been a huge drop in demand for cars, and most everything else, in the suffering Asian economies.

There has been some success in reorienting production towards exports, but retooling factories is costly and time consuming, and these companies already have big operations in the U.S. and Europe. Furthermore, redirecting exports to Japan has not been possible due to the lack of demand there. Nevertheless, Japanese automakers have done their best to maintain their commitment to the region. While production has been reduced and temporary workers cut back, most are avoiding laying off full-time employees, and some are even taking the downturn in demand as an opportunity to send employees to Japan for long periods of training (UNCTAD 1998, 217; JETRO 1999, 44). This behavior seems contrary to the frequent criticism that Japan is reluctant to transfer technology to the host economies of their investment. Japanese investment is clearly of critical importance for the region, but it has not suffered sufficiently enough as a consequence of Japan's domestic troubles for this to be the basis for outside criticism of Japan's economic policies. On the contrary, the relative stability of Japanese FDI during the crisis has undoubtedly prevented the crisis from being even worse.

Trade

A second fundamental economic tie between Japan and Asia is that of trade in goods. Japan is the greatest source imports for its Asian neighbors and is an essential export market for these economies (although

the United States and Europe each import more from Asia). How Japan's recession has affected its imports from Asia is a basic question in analyzing the role of Japan in the recovery of the crisis-hit economics. Like FDI, Japanese imports from Asia fell significantly with the burst of the "bubble" economy, due obviously to the consequent drop in consumer demand. In the case of Indonesia, Japan absorbed 42.5% of all Indonesia's exports (in dollars) in 1990, but this number fell to 30.3% in 1993 and all the way to 18.1% for the first three-quarters of 1998 (CBS 1999, 117). The fall in the price of oil (a major import commodity by Japan from Indonesia) over this period along with the recent decline of the value of the yen certainly contributes to a lower dollar value of Japanese imports, but these factors do not fully account for such a profound drop in Japan's position as an export market for Indonesia. As seen in Table 2, data for the rate of export growth for the ASEAN nations as a whole is also telling.

Exports to Japan have fallen much more rapidly than total exports. Japan bought 14.4% of ASEAN's total exports in 1995 and only 10.9% in the first half of 1998 (ASEAN 1999).

Table 2

ASEAN EXPORT GROWTH

Year	Total	To Japan
1996	9.0%	1.1%
1997	6.3%	-2.6%
1998 (1 st 1/2)	-4.5%	-17.4%

Source: ASEAN, 1999.

As Japanese consumers demand fewer goods produced in Asia the burden of absorbing these goods falls on the U.S. and Europe. The U.S. economy has been healthy enough to play this role, but this situation is a principal reason for American criticisms of Japan. Posen explains that "without Japanese economic growth at its full potential, East Asian recovery is extremely uncertain and depends all too much on exports to the remainder of the G7" (Posen 1998, 5). Robert Hormats, vice chairman of Goldman, Sachs International compares the situation to that of the Mexican crisis in 1994: "The American-led rescue of Mexico worked because the United States was growing fast enough to buy up whatever Mexico made. In Asia, that should be Japan's role as the region's leader, and its richest economy. But the Japanese seem oblivious to it" (*New York Times*, 22 February 1998). Asian exporters are now highly dependent on healthy U.S. demand -- were the U.S. economy to falter, there would be major consequences for Asia's recovery. A strong Japan would limit this risk, and a strong Japan along with a strong U.S. could provide the stimulus to speed Asia's return to economic growth.

One quantification of the effect of the Japanese economy on trade with Asia estimates that a 1% increase in GDP growth in Japan would result in an average of a 2.6% increase in exports to Japan from the five troubled economies. This in turn would contribute to an average increase in their growth rates of 0.13% (See Table 3). The OECD has conservatively estimated that Japan's average potential growth rate from 1991 on was 2.6%, while the actual average from it 1992 to 1997 was 1.2%. In 1998, Japan's economy contracted by about 3% -- the differential with a potential growth of

Table 3

ESTIMATED IMPACT OF AN ADDITIONAL
1% GDP GROWTH IN JAPAN

Increase in Imports by Japan		
Products	3.73%	
Foods	1.55%	
Materials	0.34%	
Fuels	0.91%	
Country	Increase in Exports to Japan	Increase in Growth Rate
Korea	3.14%	0.10%
Indonesia	1.86%	0.11%
Malaysia	2.54%	0.27%
Thailand	2.86%	0.15%
Philippines	3.13%	0.14%
<i>Average</i>	<i>2.62%</i>	<i>0.13%</i>

Source: Nomura, 1998.

2.6% by this model would account for an average of three-quarters of a percentage point of growth among the troubled economies. Obviously, an increase in imports by Japan alone is not going to bring the Asian economies back to their pre-crisis levels, but the contribution is measurable, and highly significant. Thus, as long as the economies of Japan and Asia continue to struggle, the U.S. and other industrialized countries will continue their aggressive push for Japan to adequately stimulate and reform its domestic economy.

Compounding the effects of Japan's recession on its neighbors is the fact that exports are the only growing sector in Japan's economy. This means that "just when other Asian economies need help, Japan has been relying on its exports, including those of its neighbors in Asia, to generate growth

at home" (Nanto 1998, 30). This is seen as particularly selfish behavior when Japan already has surpluses with most of its main trading partners and when there are alternative means of stimulating growth that have not been adequately attempted. Japan's trading relationships with its Asian neighbors are clearly of key significance under the current crisis conditions. Were Japan to stimulate its economy sufficiently to boost consumer demand, this would have measurable beneficial effects on the troubled Asian economies. Thus, foreign pressure in this regard is entirely justifiable.

Finance

Japan's economic development and persistent trade surpluses put it in the position of the world's largest creditor nation in the 1980s, with Japanese banks broadly expanding their international activities. Of course, along with FDI and trade, Japanese finance was increasingly directed towards Asia. At the end of 1996, 62.3% of the total international lending of Japanese banks, or \$242.6 billion, was to the eight Asian economies of Hong Kong, Singapore, Thailand, South Korea, Indonesia, Malaysia, Taiwan, and the Philippines (Ibid., 29).

Japan's real economic problems of the 1990s have been exacerbated by a financial crisis where its banks have faced a massive problem of nonperforming loans that the government and financial institutions have been slow to resolve. This banking problem has had global consequences in both depressing Japan's domestic growth and curtailing Japanese lending in Asia. In 1998, Japanese banks pulled out \$58 billion in credit from Asia, reducing Japan's share of all lending in Asia from a peak of 40 per

cent in 1996 to 28 per cent (*Far Eastern Economic Review*, 29 July 1999). Banks motivations to extend new loans have been further weakened by the government's necessary efforts to restructure Japan's financial industry -- banks that are over-extended face the threat of being liquidated by the Ministry of Finance which believes there are too many banks doing international business.

With the exception of Korea, the majority of Japanese loans to the region are to Japanese-affiliated companies. Due to the importance of Japanese-industry to the region, this fact obviously does not weaken the significance of the problem. Japanese FDI has remained relatively strong during the crisis, as described above, it likely could have been even stronger with a healthy financial system at home. One recent survey found that half of Japanese companies polled in Thailand have found it difficult to raise funds (*Far Eastern Economic Review*, 29 July 1999).

Ultimately the Asian crisis has affected Japanese banks more profoundly than Japan's domestic banking problems have affected Asia, but it is a circular relationship and the coincidence of the crises has negative consequences in all directions. As summarized by Rajan: "The financial crisis of East Asia has contributed to the worsening of financial sector malaises in Japan, with banks forced to 'cut losses' by refusing to roll-over existing loans, let alone extend new ones. This has created a vicious spiral of illiquidity, leading possibly to insolvency and consequent worsening of net asset positions of the (Japanese) creditors, which have in turn exacerbated the domestic and regional credit crunches (and thus the financial crisis), as

banks seek to enhance their balance sheet situations" (Rajan 1998, 3).

Japan's banking crisis has caused a significant decline in Japan's role as an international source of finance, which has certainly had some impeding effects on Asia's recovery. However, the reforms necessary to resolve the situation can only worsen the credit crunch in Asia in the short-term. The Japanese government has closed several banks and provided bail-out funds that many judge to be of sufficient quantity, thus further foreign pressure in this area is not likely to be particularly effective in easing Asia's woes.

Official Development Assistance

Among the many criticisms of Japan is that it does not provide the international leadership and support that should be offered by the world's second largest economy.

However, it is rarely praised for the indisputable fact that it is the world's largest provider of official development assistance (ODA). Japan has been the top donor of ODA for seven years running and in 1997 gave nearly 50% more than the second largest donor, France (with the U.S. coming third). Japan's aid is particularly important in Asia where a large proportion of its support is directed. In the case of Indonesia, Japan is by far the largest bilateral donor, accounting for no less than 62% of total bilateral loans by the end of 1991 (Wie 1994, 26). Japan provided 54% of ODA to the ASEAN nations in 1990, and this aid amounted to 35% of the total world bilateral ODA to developing countries in 1992 (Lincoln 1993, 181; Tan 1994, 3).

While the quantity of Japan's aid is undeniable, there are justified criticisms of

its quality. Primarily among these are its low grant to loan ratio and the self-interested commercial orientation of its aid. In 1995 and 1996 Japan ranked last among the 21 industrialized members of the Development Assistance Committee in its ratio of grant aid to loans at 41.4% (Seven countries provided 100% of their aid in grants). Nevertheless, Japan did rank second behind the U.S. in the quantity of grant aid it offered (MOFA 1999, 6-7).

A second, even stronger, criticism of Japan's aid is its self-interested commercial orientation.

Lincoln reprimands that with Japan's ODA, "behind a facade of benign generosity lay a continuing strong economic self-interest." He cites a strong relationship between the flow of aid from Japan and its volume of imports of raw materials from the recipient countries -- aiming to enhance the security of the supply which it is so dependent on (Lincoln 1993, 111; 116). Much of Japan's aid also goes to support, indirectly and directly, the interests of Japanese companies abroad. However, the fact is that Japan is not particularly exceptional in this regard. National self-interest is the major impetus of aid for most all large donor countries (Wie 1994, 25). Japan's aid certainly could involve more consideration of the real need of the recipient countries, but this could be said about any number of other large donor nations.

With regard to the crisis, while Japan has been bashed for not taking seriously its importance to the region, it has in fact provided not only the largest amount of support to the troubled economies, but the quickest. Japan organized the initial \$16 billion bailout of Thailand in August 1997

Table 4

OFFICIAL DEVELOPMENT ASSISTANCE, 1997

Country	Net ODA*	Grant Share Rank
Japan	9,358	21
France	6,348	18
U.S.	6,168	10
Germany	5,913	19
U.K.	3,371	14
Canada	2,146	12
Italy	1,231	16

*million dollars

Source: MOFA, 1999.

"when the U.S. was still sitting on the sidelines" (Terry 1998, 2). By August 1998 Japan's total support pledged to Asia was \$43 billion while the U.S. only offered \$12 billion and Europe \$7 billion (JETRO 1999, 46). A large chunk of this came with the Miyazawa Plan that offered \$30 billion to the region, and importantly which was not conditional on any domestic reforms by the recipients. The Miyazawa Plan has been acknowledged by the region as critical support for their recovery. One Indonesian businessman was quoted, "The aid program under the Miyazawa Initiative would be an important key to solving problems in the real economic sector ... it could be used to save the assets of thousands of stagnant business companies. So the fund is a big hope" (Sujatmiko 1999, 122).

In addition to the Miyazawa Plan, Japan took another strong initiative in supporting the region with its proposal for an Asian Monetary Fund (AMF). In Japan's view, an Asian-style IMF could provide a special fund to strengthen currencies before a crisis spread, avoiding the dangerous contagion

of the current crisis. Moreover, it could be used in ways compatible with Asian needs and with a shorter process" (Sujatmiko 1999, 116). Considerable opposition from the U.S. forced the proposal to be abandoned rather quickly. The main objection was that the AMF would not impose as tough conditions as the IMF, but many interpreted the U.S. opposition as reflecting its political motivations in maintaining strong influence over the IMF, and in general, all international issues that affect its national interests. "Although the U.S. would certainly deny this, it is widely believed that when it comes to global issues, the U.S. does not want Japan to play a more dominant role. When it comes to 'money' and 'finance,' the U.S. demands more and more from Japan, but when it comes to policy initiatives, the U.S. always says "Wait a minute" (Ibid.). Asian countries were enthusiastic about the AMF proposal and the idea was "regarded as a significant indication of Japan's willingness to shoulder greater responsibility for overcoming the Asian problem, and as appropriate to Japan's role as a financial leader" (Ibid.).

Finally, Japan has also acted with direct humanitarian assistance. In 1998 it loaned 900,000 tons of rice to Indonesia and provided as additional 50,000 tons as a grant. Shipment costs were borne by the Japanese government. This is the first time Japan has extended such a large amount of rice aid to a foreign country (Sujatmiko 1999, 119-120).

Japan's aid program certainly could benefit from serious re-evaluations, but it is entirely unfair to question Japan's commitment to supporting the region with official relief. If the Asia crisis was any test of

this commitment, Japan should be praised for passing with flying colors. If there are legitimate reasons for criticism of Japan's economic policies during the crisis, its official aid programs are not among them. However in the grand scheme of Asia's long-term recovery, ODA is probably only of secondary importance. Posen describes comparisons of explicit lending initiatives as a mere "side show" from the real issues (Posen 1998, 5). Summers discounts the relevance of Japan's official support, proclaiming "One thing is certain: trade is better than aid" (Summers 1999, 4).

The Yen

The final economic factor examined here that relates Japan's troubles to those of Asia is that of the yen. Currency relationships are of course inextricably tied to those of international trade and investment, so there are implications here to the proceeding discussions. Basically, a weak economy causes a nation's currency to weaken, which potentially has negative consequences on other economies to which the troubled economy is linked. The Japanese yen fell sharply as its economy suffered through 1997 and 1998, from a high of about 112 yen to the dollar to a low of about 147 -- a depreciation of more than 30%. After quick strengthening in late 1998 then yen has steadily, although moderately, weakened in 1999.

A weak yen reduces the relative attractiveness of assets in East Asia, diminishing incentives for Japanese FDI (Rajan 1998, 4). Although we have seen that Japanese FDI has remained relatively strong throughout the crisis, a stronger yen could only have enhanced this. More important, a weak

yen hurts the export competitiveness of Japan's trading partners, depriving Asian economics of export opportunities to stimulate their recoveries. In addition, a further weakened yen could give China an excuse to devalue its own currency, which could have profound implications on Asia's recovery, for the same reasons. Finally, a weak yen threatens to provoke projectionist pressures in the U.S., which can only hurt the world trading system.

One serious analysis uses a general equilibrium model to quantify the consequences of a weak yen. It concludes, "real depreciation of the yen will have significant adverse affects on the rest of Asia, even if Japanese growth is restored. The reduction in the emerging surpluses of the crisis-affected countries is greater than the Japanese bilateral aid commitments under the IMF programs in Thailand, Indonesia, and South Korea" (Noland, Robinson, and Wang 1998, 5). Thus, not only is trade better than aid, but so is a strong, stable yen.

It seems clear that Japan has intentionally tried to maintain her weak yen. "Data holdings of foreign exchange reserves by Japan indicate that Japan has been following a deliberate weak-yen policy despite the Asian financial crisis" (Nanto 1998, 31). The accumulation of reserves by the Bank of Japan is the indicator of this. If Japan's policy was to stabilize its exchange rate, changes in holdings of foreign reserves and the level of its exchange rate should move in opposite directions -- when the yen is weakening, Japan should be selling exchange and vice versa -- if accumulating foreign exchange at the same time that its currency is weakening, it is pursuing a "weak-yen" policy (Ibid.).

Japanese officials have acknowledged that this is indeed their current policy -- that they are ready to intervene in the currency market to weaken the yen as a way of stimulating economic growth. Obviously Japanese growth is what we are after, but this method of growth that is based on making exports more competitive is counter-productive in offering any benefits to other Asian economics.

Japanese policy along with the continued relative weakness of their economy is likely to lead to further declines in the yen. Most analysts predict that it will weaken by 15% or more by the end of the year from the rate of around 120 yen to the dollar in June. The most pessimistic forecasts have the yen weakening by 40% before the end of the year (*International Herald Tribune*, 24 June 1999). Such depreciation would acutely limit the prospects for Asia's recovery in the near future. At the same time, the currencies of the troubled Asian economies are strengthening, compounding the difficulties caused for their export industries. The value of the yen may indeed be the most important factor under Japan's control in affecting Asia's recovery. "While trade is the most obvious negative, probably the most important negative for the rest of Asia the continued decline in the value of the yen relative to the dollar" (Patrick 1998, 433).

Concluding Remarks

Japan's post-war evolution into the world's second largest economy has obviously brought it into a position of serious weight. However, Japan's gradual economic focus on Asia, primarily over the past two decades, has shifted the weight of its in-

fluence more towards its neighbors. The level of economic ties achieved between Japan and the rest of East Asia by the 1990s has made the coincidence of Japan's recession and the Asian crisis highly threatening. And this threat has provoked a new wave of attacks on Japan's economic policies. Despite countless claims about Japan's importance to the region, there have been few attempts have been made to analyze which economic ties are of key significance.

This paper has been a modest attempt at such an analysis and concludes that Japanese FDI and ODA in Asia have not been significantly weakened by Japan's domestic troubles, but rather Japan has continued to be the strongest and steadiest source of both. On the other hand, Japan's trading relationships in Asia and the value of the yen have been considerably hurt by Japan's recession and in turn are a major drag on Asia's prospects for recovery. Pressure on Japan to make stronger efforts at stimulating domestic demand is legitimate. However there has been less attention given to the importance of the value of the yen, which may be an even more important factor. Despite falling on nearly deaf ears, the criticisms and pressure on Japan will undoubtedly continue -- the merits of a change in diplomatic tactics is another question.

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Governance in East Asia: The Case of Hong Kong Interactions Between Economic Development and Democracy*

Joseph Y.S. Cheng

Introduction

BY the summer of 1999, confidence was again rising in the East and Southeast Asian countries deeply affected by the financial crisis of the previous two years. Hence all parties concerned can now examine the crisis and attempt to learn from it in a more objective manner. While the immediate consideration, regional and international, has been with the prospects of an economic recovery, the recent Asian financial crisis has been forcing people in the region to re-assess their future and in fact the meaning of life.

An important question to address is democracy. Authoritarian leaders in Asia who brush off democracy and political freedom

do not represent the wishes of their people. Admittedly when Asians attempt to make a list of their values, they usually emphasize the family, education, hard-work, thrift, harmony, etc. Often democracy and political freedom tend to be down-played. Yet even an illiterate peasant in a remote Chinese village treasures his right to articulate his grievances, and he yearns for the power to remove corrupt local officials.

The educated middle class in Asia appreciate the importance of democracy and the rule of law. Their fundamental concern is not the acceptance or rejection of democracy, but the process and the associated risks in attaining it. Economic growth in East and Southeast Asia had generated a complacency regarding the *status quo* and fear of major changes. They had been exploited by authoritarian leaders to delay the democratization process. But when the middle class in the region is decisively mobilized to fight for democracy, it usually wins, and often without much violence and bloodshed, as has been demonstrated in South Korea, Taiwan and Thailand.

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The recent economic crises in many countries in East and Southeast Asia have brought much pain to the people. The social consequences included a steep increase in poverty and unemployment, the removal of tens of thousands of children from schools because their families could no longer pay for their education, and the closure of hospitals and other basic services. Though there were complaints against overseas speculators and suspicions against Western countries generated by various conspiracy theories, there is no denying that people in these countries understand that "corruption, collusion and nepotism" were the basic causes of their economic problems. As a result, there have already been changes of governments in Thailand, South Korea and Indonesia. Joseph Estrada won the presidency in the Philippines by presenting himself as the champion of the poor and underprivileged. The new governments in these countries have all been implementing a broad range of economic, regulatory and legal reforms. Moreover, it does not appear that nationalism has been rising in any significant manner.

In Thailand and South Korea, where competitive, multi-party systems exist and the media are relatively free, changes of governments have been achieved through the ballot boxes, and they have not exacerbated tensions in the communities. In contrast, President Soeharto of Indonesia was brought down by mass demonstrations which were accompanied by racial riots and abuses of human rights. In the former two countries, stability has been maintained. In Indonesia, however, considerable unrest still remains.

It becomes increasingly clear to people in the region that economic security, po-

litical democracy and the rule of law are inter-related. Without the latter two, corruption, collusion and nepotism will flourish, and they in turn will threaten economic security and development. Even from a utilitarian point of view, political democracy is essential to guarantee economic security.

More important still, people in the region are not satisfied with the mere existence of a democratic political system. No one can deny that democracy exists in Japan, South Korea, Thailand and the Philippines, yet the democratic political systems have not been effective in curbing corruption and collusion as well as enforcing transparency. A more participatory political culture has to be developed to ensure transparency, accountability and proper checks and balances. In short, the underdeveloped civil society and its various channels of political participation have a lot of catching up to do. The ultimate test lies in whether people secure a sense of satisfaction through participation. Instead of focussing on voting behaviour, one has to take note of other forms of participation such as involvement in signature campaigns, donations to political parties, taking part in public demonstrations and marches, attending meetings concerned with public affairs, writing to newspapers or calling in to radio and television talk-shows. The media in Indonesia have become much more lively since the fall of Soeharto.

The push for transparency and the development of effective regulatory and commercial law systems are basically political decisions, since autonomous institutions limit the exercise of arbitrary political power and thus help to eliminate corruption, collusion and nepotism. Respect for the rule of law will

provide a firm foundation for political reforms and genuine democracy.

This article attempts to give an account of the political modernization of Hong Kong and to discuss the significant factors and variables involved in the process. In particular, the interactions between market forces and democracy are analyzed. It is hoped that an examination of the Hong Kong case study will help to shed light on the general theme of governance in East Asia.

Post-War Political Development in Hong Kong

Until the early 1980s, political participation was very limited in Hong Kong, the constitutional structure of the colonial government had not experienced any major changes, and there were few demands for political reforms. Many attempts have been made to explain the political apathy of the Hong Kong community before the early 1980s.¹ After all, the potential for social mobilization was very considerable: Hong Kong people had a very high literacy rate, they were quite well educated (since the 1970s, the government has been providing nine years of free compulsory education), and the mass media were well developed (by the early 1980s, almost every family had a television set and a radio, and local newspapers and magazines enjoyed wide circulation).

The first general explanation was the refugee mentality among the Hong Kong population after the Second World War. From the late 1940s to the early 1950s, most peo-

ple came to Hong Kong as refugees. They obviously did not have much sense of belonging, and lacked any consciousness of being citizens of Hong Kong. They would be satisfied as long as they could make a living, with the colonial government maintaining law and order. Colonial rule was an affront to national pride, but when compared with the rampant warlordism, chaos, corruption and the abuse of power in China in the first half of this century, it was quite acceptable. The political chaos and civil war in China had disappointed most of the nation, especially those who fled the Motherland to a British colony. Many of these refugees made a deliberate decision not to get involved in politics, and they taught their children to do the same.

Language and law were important factors that could not be overlooked. The official language in Hong Kong was English, the law was English common law. Without an adequate grasp of the official language and the legal system, it would almost be impossible to engage in peaceful political struggles. The independence movement in India is a good example. Many political leaders of the independence movements in former British colonies were graduates of Oxford and Cambridge, and quite a few of them had law degrees. In the 1970s, most activists of the political groups in Hong Kong graduated from the colony's two universities earlier in the decade. They had an adequate command of English, and understood the colony's political economy and the legal system well. Many of them came from the lower-middle socio-economic strata too. On the other hand, the 1961 Census showed that Cantonese (a southern Chinese dialect) was the mother tongue of the majority of the urban population, with 806 out of every

¹See the author's "Political Modernisation in Hong Kong", *The Journal of Commonwealth & Comparative Politics* XXVII, no. 3 (November 1989): 294-320.

1,000 inhabitants of Hong Kong, Kowloon and New Kowloon speaking Cantonese, while only 13 people in every 1,000 spoke English.² At that time, most people believed that the pressure of public opinion had to work through the English mass media, and only "letters to the editor" in the English press would receive the attention of government officials.

The refugee mentality under colonial rule is a kind of political alienation. This political alienation made ordinary Hong Kong people feel that they had no channel of political participation and that they could not influence government policy and administration. As commonly conceived by political sociologists, the term "alienation" describes three different but related sets of attitudes, namely, the sense of powerlessness, the sense of meaninglessness and the sense of isolation.³ Hong Kong people at the grass-roots level did not know English, did not understand the law and suffered from a sense of political impotence. They moved from the Chinese Mainland to Hong Kong, abandoned their traditional rural and lineage organizations and felt acutely isolated in a big city. A good illustration of this isolation was the popularity of clansmen's associations in the 1950s and their marked decline since the early 1970s. People who arrived at Hong Kong usually considered their clansmen and people from their hometowns their first points of contact; and those who had esta-

blished themselves often felt an obligation to help those from their clans or hometowns when they were in need. These ties became insignificant as people became integrated into the community, and they developed friendships in their neighbourhoods and work-places. As life became busy, people often found it difficult to maintain their clan-ship ties.

Since the establishment of the People's Republic of China (PRC), the British administration had been attempting to suppress the activities of the Kuomintang and the Communist Party of China (CPC). Occasionally, the British administration exercised its emergency powers and exiled some political activists. The vast majority of Hong Kong people did not want to get involved in the political struggles between the Kuomintang and the CPC, and were afraid of retaliation from the British administration. In the earlier decades, the colonial police was also quite rough towards those from the lower socio-economic strata; taking part in petitions, demonstrations, etc. would have involved some risks.

At the same time, the middle class was also afraid that serious political changes in the territory would lead to interference from Beijing and its regaining control of the colony. The local middle class was quite well educated and enjoyed relatively high incomes; it had no great expectations of the British administration and was generally satisfied with the *status quo*. After all, the middle class and professionals in Hong Kong had been enjoying the highest living standards in Asia.

The colonial education system played a significant role in suppressing the potential demand for political participation from the

²Alice K. Wong, "Political Apathy and the Political System in Hong Kong", *United College Journal* (Hong Kong) 8 (1970-71): 19.

³See Lewis Feuer, "What is Alienation? The Career of a Concept", in M. Stein and A. Vidich (eds.), *Sociology on Trial* (Englewood Cliffs, New Jersey: Prentice-Hall, 1963): 127-147.

middle class.⁴ As in other societies in East Asia, education provided the most important channel for upward social mobility in Hong Kong. A university graduate almost automatically became a member of the middle class, and those with a law degree or a medical degree had a fair chance of moving into the upper strata of society.⁵ The open, fair and competitive education system provided hope for the hard-working parents; those with high expectations for their children tended to identify with the existing systems and their dissatisfaction and social frustration were to a large extent reduced.

It is an exaggeration to describe this education system as indoctrination, but this system never attempted to encourage students to become interested in public affairs, and no efforts were made to cultivate a sense of citizenship and a critical attitude. Those who managed to succeed through this channel of upward social mobility were readily accepted by the elites; and the former in turn became inclined to support the existing systems. The rich men in Hong Kong differed from their counterparts in Europe in that they would not stress their family background; they were usually proud to talk about their childhood poverty. The quality products of the territory's education system normally had a better command of English than Chinese; and from their individual ca-

reer's point of view, they could strive for acceptance by the establishment and naturally had little motivation to push for reforms through political participation.

To the business community, the market economy of Hong Kong is probably the freest in the world and experiences the least interference from the government. In the past, the freedom of the market economy had been effectively protected by government officials.⁶ To a large extent, senior officials of the British administration in Hong Kong were a neutral administrative elite without direct ties to the business community. Appointed by the British government, they were constitutionally accountable to the British government. In practice, in the post-war years up to the beginning of the Sino-British negotiations on the territory's future, the Hong Kong government had encountered little interference, from London. Senior bureaucrats of the British administration in Hong Kong respected the rule of law and were guided by the political philosophy of *laissez-faire* (or positive non-interventionism), and ultimately they had to be responsible to a democratic government in London.

The post-war economic development in Hong Kong differed from that in the other "little dragons of Asia" (Singapore, Taiwan and South Korea). The major enterprises in the territory had not received any direct assistance from the government. Part of their capital came from the Chinese entrepreneurs (mostly from Shanghai) who fled to Hong Kong in 1949-50, and the rest from the banking system in Hong Kong for which a firm

⁴There are no concrete published materials on the subject. On the development of Hong Kong's education system, see Yee-wang Fung, "Education", in the author's edited work, *Hong Kong in Transition* (Hong Kong: Oxford University Press): 300-330.

⁵There are again no concrete published materials on the subject. One may refer to Alice K. Wong, *The Study of Higher Non-Expatriate Civil Servants in Hong Kong* (Hong Kong: Social Research Centre, Chinese University of Hong Kong): 1972.

⁶See Norman Miners, *The Government and Politics of Hong Kong*, Hong Kong: Oxford University Press, 1991, 5th edition, Chapter 4 "Economic Constraints and the Government's Ideology", 43-50.

foundation had been established when the territory served as an *entrepot*, as well as from the subsequent accumulation of the enterprises themselves. On the other hand, much of the capital of the major corporations in Taiwan and South Korea came from government-owned financial institutions, and the corporations maintained close ties with the respective governments and ruling parties.⁷ The governments in Taipei and Seoul assumed a considerable guidance role in their respective market economies; and in the 1950s and 1960s, various regulatory and control schemes hindered the operation of free markets. The business communities were forced to maintain cordial relations with government officials, and it was not uncommon to offer political donations in exchange for favoured treatment from the government authorities. Even in Singapore, the guiding hand of the government was obvious in the market economy: the priority accorded to the "strategic industries" of electronics, petrochemicals, etc. in the early 1970s was a good example.

In Hong Kong, a basic separation between economics and politics had been maintained, and the business community had full confidence in the government's observance of the operational principles of a free market economy. Business leaders, having made their fortunes, could easily gain honours (such as knighthoods from the British Crown) and social status through donations to respectable philanthropic organizations, and were generally not interested in politics. This is not to deny the fact that until the mid-1980s, major British corporations such as the

Hongkong and Shanghai Banking Corporation and the Swire Group had been offered seats in the Executive Council (equivalent to the Governor's cabinet) so that their interests would be safeguarded. In the past decades, the business community was satisfied with the positive non-interventionist political philosophy of the British administration, and it had not raised specific demands for direct assistance from the British administration. Since the late 1960s, the establishment of the Hong Kong Trade Development Council, the Hong Kong Productivity Council, the Hong Kong Export Credit Insurance Corporation and the Hong Kong Industrial Estates Corporation had been designed to serve the long-term economic interests of the territory, through the offer of the necessary infrastructure by the government for the smooth functioning of the private sector. Owing to its small and open nature, Hong Kong's economy was vulnerable to external factors, and government action to offset unfavourable external factors was often of limited effectiveness. The British administration was of the view that, except where social considerations were regarded as overriding, the allocation of resources in the economy would normally be most efficient if market forces were relied on and government intervention in the private sector was kept to a minimum. The government considered that the narrowly based tax structure with relatively low tax rates provided incentives for hard work and investment, and that the primary role of the government was to provide the necessary infrastructure and a stable legal and administrative framework conducive to economic growth and prosperity.⁸

⁷Regarding the situation in South Korea, see Mark Clifford, "Filing for divorce" and "Playing the game", *Far Eastern Economic Review* 140, no. 16 (April 21, 1988): 58-60.

⁸Government Information Services Department, *Hong Kong 1987* (Hong Kong: Government Printer, 1988): 55.

Though the free market economy led to the concentration of wealth and the unequal distribution of income, yet in a colonial political system, power had been highly concentrated in the senior officials of the colonial government and had not been affected by economic development. This separation of political power and wealth in fact constituted a form of checks and balances. The considerable gap between the rich and poor too had not paved the way for a strong labour movement. The sense of political impotence, isolation and alienation on the part of ordinary people, the lack of support from middle-class intellectuals in the organization of workers for their rights, and the general fear of involvement in politics suppressed the demand for political participation among the lower socio-economic strata. More important still, the spectacular economic growth in Hong Kong since the 1950s improved the community's living standards significantly, and provided ample white-collar jobs and opportunities for starting small businesses. Together with the vast expansion of the education system, all these made the people realize that they could solve their problems through their own efforts without having to exert pressure on the government by political participation. These factors also constituted the basis of a political culture depicted by Siu-kai Lau as "utilitarian familism".⁹

Changes in the 1970s

Since 1970, those who have been born in Hong Kong and grew up in the territory

gradually became the majority in the population. They did not share the refugee mentality with their parents, they had a strong sense of belonging to the territory and were proud of its achievements. Secondly, the spread of education and economic development created a significant middle-class; many citizens also began to have a good understanding of their rights and obligations. After fulfilling the obligations of paying taxes and obeying the law, it was natural that people started to demand political rights. Further, in a modern metropolis, the daily life of the citizens was closely related to government policies. As government expenditure on social services expanded, its ability to interfere in the economy also increased. Policies on the provision of public housing and nine years of free education affected almost every family. It was a natural and inevitable development that people would demand to take part in policy-making in order to protect their own rights. These factors also became the foundation for various campaigns for citizens' rights.

Such campaigns developed at two levels. Regarding issues with a direct impact on their daily life, people from the lower socio-economic strata gradually learned to organize themselves to appeal to public opinion, to petition and to engage in various forms of protest activities to protect and promote their interests. Social workers from voluntary agencies funded by Western churches and student activists from the tertiary educational institutions also began to take part in these campaigns. In the late 1970s, the development of grassroots pressure groups reached the stage when territory-wide campaigns for citizens' rights could be organized. Classical examples were campaigns against the raising of bus fares and those demanding citizen

⁹See Siu-kai Lau, *Society and Politics in Hong Kong* (Hong Kong: The Chinese University Press, 1982); and the author's "Hong Kong Citizens' Push for Power", *Asiaweek* 8, no. 51, (December 24-31, 1982): 49-50.

supervision of the monopolistic electric power companies.

The problem for such grassroots pressure groups was that people were as yet reluctant or unable to fight for their interests from a macro point of view instead of a micro one. Great difficulties existed in mobilizing people to become concerned with and to supervise the government's major policies. This showed that ordinary people were only willing to fight for immediate interests directly related to their daily life, and they were not concerned with the government's decision-making process.

At the same time, student movements developed in the tertiary educational institutions. They played an important role in the campaign for Chinese as an official language.¹⁰ But their ideals and concern for global developments and their positions on developments in the Motherland (People's Republic of China) obviously could not appeal to the grassroots pressure groups. In the second half of the 1970s, political groups such as the Hong Kong Observers emerged. They represented the local-born generation of middle class intellectuals, hoping to supervise and criticize the government through objective research, exerting pressure on the government by influencing public opinion.¹¹

¹⁰See King-eheung Chan, "Hong Kong's Student Movement" (in Chinese), in the author's edited work in Chinese, *Hong Kong's Political System* (Hong Kong: Cosmos Bookstore Ltd., 1987): 289-314; and Hong Kong Federation of Students (ed.), *Review of Hong Kong's Student Movement* (in Chinese) (Hong Kong: Wide Angle Press Co. Ltd., 1983).

¹¹See the Hong Kong Observers, *Pressure Points* (Hong Kong: Summerson (HK) Educational Research Centre, 1983, enlarged and updated edition.

It is significant that the campaigns for citizens' rights and the community organizations at the grassroots level in the 1970s basically accepted Hong Kong as a free market economy, and did not demand reforms of the existing economic system. They asked the government to do more for the lower socio-economic strata, but they did not have a blueprint for a welfare state. They realized too that no radical ideologies could attract a sizeable following in the territory. Class consciousness was weak, even blue-collar workers had no strong sense of class identification and were reluctant to join trade unions. Most parents in the lower socio-economic strata hoped that their children would become middle-class professionals. They themselves could easily leave the ranks of the proletariat; it was not too difficult to become hawkers, street-stall owners or owners operators of taxis.

In response to the rising demand for political participation in the 1970s, the British administration in Hong Kong became much more active in the provision of social services and in the process of "administrative absorption".¹² The former satisfied the demands of the community, solved the daily problems of the citizens and reduced the contradictions in the society. It certainly weakened the tendency of the lower socio-economic strata to fight for their rights through political participation. While protecting the functioning of the free market economy, the government began to promulgate labour legislation in the 1960s to protect the rights of labourers and improve their working condi-

¹²See Ambrose Yeo-ehi King, "The Administrative Absorption of Politics in Hong Kong", *Asian Survey* 15, no. 5 (May 1975): 422-439.

tions and environment.¹³ The British administration probably anticipated the pressure of international public opinion, and tried to improve Hong Kong's image as a manufacturing centre while opening up overseas markets. It obviously wanted to avoid being attacked for exploiting cheap labour in the promotion of exports.

In the 1970s, social services provided by the government expanded rapidly. They served to improve the community's quality of life (especially public housing), offer opportunities for upward social mobility (especially the provision of nine years of compulsory education and the expansion of tertiary educational institutions), establish a social security net, (through the Public Assistance Scheme and related social welfare programmes), etc. What Samuel P. Huntington considered to be the source of political instability -- the gap between social mobilization and economic development -- was largely eliminated, and the demands for political participation and democracy failed to lead to a strong movement.¹⁴

At the same time, the British administration learned a lesson from the riots in 1966 and 1967 and became more responsive to public opinion. Senior government officials became more willing to contact political activists and were willing to make tactical concessions while upholding the government's political philosophy. The police too respected Hong Kong people's right of petition and protest. These changes of attitudes on the

part of the British administration had their impact on the community's political culture: Hong Kong people gradually appreciated their right of articulating their grievances, and soon became skilful in exploiting petitions, rallies and protests to influence public opinion through the mass media. They were usually careful to act within the law, and political activists often maintained a good relationship with the police.

The British administration even claimed to be a "government by consultation". The system of advisory committees following the British tradition was further developed to involve community leaders of the upper socio-economic strata, and such "administrative absorption" was used to strengthen the colonial government's representativeness. According to a study by Ambrose King, before 1964, over 90% of the Chinese unofficial members of the Legislative and Executive Councils came from the established rich families of the territory. Since the mid-1960s, members of the "new rich" -- the industrialists who made their fortunes after the Second World War -- began to be appointed to the Legislative and Executive Councils.¹⁵ In the 1970s, the government's consultative network expanded considerably. After the "new rich" industrial elite, established professionals in their thirties and forties also became targets of "administrative absorption". In the early 1980s, some pressure group leaders who established themselves as respectable critics of the colonial regime were also admitted into some important advisory committees.

¹³See Sek-hong Ng, "Labour" in the author's edited work, *Hong Kong in Transition*, 268-299.

¹⁴See Samuel P. Huntington, *Political Order in Changing Societies* (New Haven, Connecticut: Yale University Press, 1968).

¹⁵Ambrose Yeo-chi King, *op.cit.*, 426-427 and 429-430.

The City District Officer Scheme, which started in 1968 as a response to the 1966-67 riots, also expanded in the 1970s. This enabled the government's consultative network to reach the grassroots and facilitated the absorption of the activists at the grassroots level into its system of advisory committees.¹⁶ In 1972, each City District Office set up within the district a number of area committees whose members were community leaders nominated by the City District Officer. In the following year, the government encouraged residents of public housing estates and private residential blocks to form mutual aid committees in support of its Fight Crime Campaign and Clean Hong Kong Campaign. Earlier, the government also persuaded the owners of private housing to organize owners' corporations to promote better building management and security.¹⁷

On the whole in the 1970s, demand for political participation among the younger generation began to germinate, and ordinary people also learned how to get organized to protect their rights. However, spectacular economic growth and the development of social services offered by the public sector much weakened the community's demand for political participation; and the government's aggressive "administrative absorption" and expansion of its consultative network also softened such demands from the political activists. Throughout the decade, development in political participation was

limited to supervision and criticism of the government, influencing government policies and exerting pressure on the government through mobilizing public opinion, organizing pressure groups and *ad hoc* campaigns. There were no strong demands for constitutional reforms from the community, and the British administration was not tested by any serious challenge.

Development of Representative Government and the 1997 Issue

In 1982-1985, concern for the future of the territory and the challenge posed by the development of representative government contributed to the organization and development of many political groups and grassroots pressure groups. Earlier in June 1980, after the visit of the Governor, Sir Murray MacLehose, to Beijing in March 1979, a district administration scheme was presented by the government proposing the election of district boards.¹⁸ This was an important step towards democracy because universal suffrage was introduced, and Hong Kong people could elect representatives to district boards which, though had no important powers, were given the responsibility to advise the government on the well-being of district residents.

The first elections to the Legislative Council in September 1985 were based on the electoral college, comprising members of the district boards, the Urban Council and the Pro-

¹⁶*The City District Officer Scheme. A Report by the Secretary for Chinese Affairs*, Hong Kong: Government Printer, January 1969.

¹⁷See Cho-bun Leung, "Community Participation: The Decline of Residents' Organizations" in the author's edited work, *Hong Kong in Transition*, 354-371; see also David K.K. Chan, "Local

Administration in Hong Kong", in Alex Y.H. Kwan and David K.K. Chan (eds.), *Hong Kong Society - A Reader* (Hong Kong: Writers' & Publishers' Co-operative, 1986): 111-135.

¹⁸*Green Paper: A Pattern of District Administration in Hong Kong* (Hong Kong: Government Printer, 1980).

visional Regional Council, as well as on the functional constituencies.¹⁹ Qualified voters only numbered about 70,000, and those who actually voted amounted to about 25,000. The scale of political mobilization was limited as many people were unaware of the elections, but they were nevertheless a significant step in Hong Kong's political development. Twenty-four of the fifty-six Legislative Councillors had to be accountable to their respective constituencies, unlike the appointed unofficial members, who were accountable to the Governor of Hong Kong who made the appointments.

By the end of 1985, London and the British administration accepted Beijing's demands for convergence with the Basic Law, the constitution of the Hong Kong Special Administrative Region (HKSAR), meaning that they would cede the initiative of political reforms to the Basic Law Drafting Committee, appointed by and accountable to the National People's Congress (the legislature of China) in Beijing.²⁰ The British administration in Hong Kong subsequently postponed the introduction of direct elections to the legislature from 1988 to 1991. Compromises between the Chinese authorities and the British administration led to a common stand between the pro-Beijing groups and the pro-business conservative forces in the

territory opposing further development of representative government as advocated by the pro-democracy camp supported by the grassroots community organizations.

Development of representative government in the 1980s enabled grassroots community organizations and trade unions to become formidable forces in elections, thus enhancing their influence on the government and reinforcing the latter's responsiveness to their demands. Their respectability and legitimacy were fully accepted by the Establishment. Yet the development of social services provided by the public sector entered a stage of consolidation. The rapid economic growth in the 1970s and the ambitious programmes of the MacLehose administration largely satisfied the community's basic demand for social services. Anticipating slower economic growth in the future, and in view of the natural expansion of the existing programmes, the British administration had to reconsider its various social service commitments. The increase in the ratio of Home Ownership Scheme flats to rental public housing flats, the doubling of rents for public-housing tenants whose incomes exceeded the income limits for applicants and who had been residing in public housing for more than ten years, the establishment of an independent Hospital Authority to manage public hospitals, etc. all demonstrated the British administration's intention to limit its social service commitments. Due to the uncertainty over Hong Kong's future, Beijing and all parties concerned wanted to maintain the territory's attraction to investors, and thus much weakened the demand for more social services and a greater degree of income redistribution. A good example was the British administration's plain rejection of the proposal for a central provident fund scheme.

¹⁹The nine functional constituencies returning 12 unofficial members comprised the commercial, industrial, financial, labour, social services, educational, legal, medical, and engineering and associated professions. See *White Paper: The Further Development of Representative Government in Hong Kong* (Hong Kong: Government Printer, November 1984), 17.

²⁰See the author's "Hong Kong: the pressure to converge", *International Affairs* (London) 63, no. 2 (Spring 1987): 271-283.

The conservative business leaders' attacks on "free lunches" (social service programmes of the public sector) resulted in considerable self-restraint among the pressure groups within the pro-democracy camp. In the latter half of the 1980s, the British administration offered no new major social welfare programmes. Nor had the community made any specific demand. The proposed central provident fund scheme involved no direct financial burden on the part of the government. The community was aware of Beijing's demand for balanced budgets; and in the late 1980s, the Governor and the Financial Secretary indicated that the expenditure of the public sector should be kept at the level of about 16% of the territory's gross domestic product.

Besides the above factors, Hong Kong's traditional political culture encouraged self-reliance, and the past spectacular economic growth as well as the anxiety over the future had lowered the community's expectations of social services from the government. Hence, the contraction of the public sector and the reduction in the growth of social services did not cause much dissatisfaction in the community, and there were no indications that people had been prompted to satisfy their demand for social services through political participation. In fact, in view of the Chinese leadership's position on the development of representative government in Hong Kong, people's expectations of democracy had been lowered.

By the spring of 1988, it was clearly revealed that the mainstream view within the Basic Law Drafting Committee favoured an "executive-led" government for the future HKSAR, with power concentrated in the

hands of the Chief Executive.²¹ The Chief Executive would be elected by a grand electoral college of about 600, which would also have the power of electing one quarter of the members of the legislature. Further, the first government and legislature of the HKSAR would be elected by an Election Committee formed by a Preparatory Committee appointed by the National People's Congress, thus giving Beijing a large measure of control. A leader of the local pro-democracy camp, Szeto Wah, attacked the system as "dictatorship of the grand electoral college", and he asked members of the pro-democracy camp to be prepared to remain in opposition for twenty years.

Challenges in the 1990s

The Tiananmen Incident in June 1989 stimulated the development of political parties in Hong Kong and contributed much to the spectacular electoral victory of the pro-democracy camp in the first direct elections to the Legislative Council in 1991. In the 1989-1991 period, the community was highly politicized, and its attention concentrated on emigration, further development of representative government, relations with China, political developments in China and the state of the Hong Kong economy.

The pro-Beijing united front suffered tremendously in the immediate aftermath of the Tiananmen Incident, but it recovered quickly once the stability of the Chinese Communist regime had been confirmed. On the whole, the Chinese authorities have been very success-

²¹See the Drafting Committee for the Basic Law, *The Draft Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* (for solicitation of opinions) (Hong Kong: Drafting Committee for the Basic Law, April 1998).

ful in winning over the elites in the territory. In the approach to 1997, Hong Kong's Establishment, in order to protect its vested interests, had been eager to indicate its support for China's Hong Kong policy.

Since the conclusion of the Sino-British Joint Declaration in 1984, Chinese leaders have been according top priority to the cultivation of the business community in the territory. Their rationale is simple and straightforward. Hong Kong must remain attractive to investors. If investors stay, then stability and prosperity of the territory will be maintained. From the membership of the Basic Law Drafting Committee to those of the Preparatory Committee for the HKSAR and the Selection Committee for the first government of the HKSAR, it has been clearly demonstrated that business leaders dominate.²² The business community in return firmly supported the Chinese government in the Sino-British conflict. It has confidence in China's economic reforms and its opening up to the outside world. The momentum picked up very quickly after the Tiananmen crackdown. Business people believe that the trend is irreversible. Hence they have been very bullish about the economic future of China and Hong Kong's role in China's development.²³ Since Chinese enterprises invest substantially in the territory, and most major Hong Kong firms have businesses in China, it is only natural that the latter have been eager to establish their *guanxi* (relationship) networks in China. Em-

phasis on *guanxi* means that fair competition cannot be maintained; and fair competition has been an important factor for Hong Kong's success.

In terms of political participation, local business leaders enjoy access to top Chinese leaders. When the latter visit Guangdong (a province in southern China bordering Hong Kong), they typically would arrange to see some of the richest Hong Kong tycoons. Local business leaders believe that their interests are respected by the HKSAR government and they consider that the best way to articulate their interests is to cultivate and maintain good relations with the Chinese leadership. The most effective means of achieving this end appears to be major investments in China and generous donations.

In the design of the Basic Law and the political system for the HKSAR, the Chinese authorities' demand for the final say is clearly reflected in their retention of the powers of interpreting and amending the Basic Law (Articles 158 and 159).²⁴ Regarding the political system, both the Sino-British Joint Declaration (Annex I, Article 1) and the Basic Law (Articles 45 and 48.5) provide the Central People's Government in Beijing with the power to appoint the Chief Executive and the principal officials of the HKSAR government. The Basic Law also stipulates that the Chief Executive "shall be accountable to the Central People's government and the Hong Kong Special Administrative Re-

²²For an analysis of the membership of the Selection Committee, see *Sing Tao Daily* (a Hong Kong Chinese newspaper), November 3, 1996.

²³See, for example, Bruce Gilley, "Red Flag over Hong Kong", *Far Eastern Economic Review* 158, no. 49 (December 7, 1995): 72-78

²⁴For an analysis of the Basic Law and the political system, see the author's "The Basic Law: Messages for Hong Kong people", in Richard Y.C. Wong and the author (eds.), *The Other Hong Kong Report 1990* (Hong Kong: The Chinese University Press, 1990): 29-63.

gion in accordance with the provisions of this Law" (Article 43).

The HKSAR political system as outlined in the Basic Law enables the Chief Executive to be a very strong leader within the local government. The Chief Executive has powers and functions similar to the United States President, though the former probably has even larger powers *vis-à-vis* the legislature. In sum, the political system outlined in Chapter IV of the Basic Law presents an "executive dominant" system in which the Chief Executive has powers similar to those of the previous British Governor. The Legislative Council has only limited powers.

In both the election of the first Chief Executive and that of the provisional legislature in late 1996, the Chinese authorities wanted to make sure that nothing would go wrong. The processes well demonstrated the style of "election with Chinese characteristics". The first Chief Executive was, as expected, someone well trusted by Beijing and accepted by the business community. Siu-kai Lau, a Preparatory Committee member heavily involved in the design of the political system of the HKSAR, observed that the Chinese authorities were also satisfied with the outcome of the provisional legislature election. He noted that since no political party could dominate the provisional legislature, the executive would not be restrained by the provisional legislature.²⁵ At the same time, the pro-Beijing camp clearly controlled a stable majority in the provisional legislature.

The vast majority of Hong Kong people have, to some extent, accepted the substitution of stability and prosperity for democracy. They have lowered their expectations of democracy because they realize that this is not a realistic goal and they value the high living standards which the territory has been offering them. They, and especially the middle class, are also aware that there are no greener pastures outside Hong Kong. Hence the community has adopted a very accommodating attitude.

The Chinese leadership's top priority in its policy towards Hong Kong has been the maintenance of the territory's stability and prosperity. It is similar to the Chinese leadership's domestic disposition in the post-Deng era: *wending yadao yiqie* (stability is more important than anything else). Given Hong Kong people's traditional political values, fear of major changes and concern for the economy and employment, there is no incentive to challenge the Chinese authorities. Order is established through gradually reducing the gap between the expectations and objectives on the part of Beijing and those on the part of Hong Kong people. Maintenance of the existing economic order has paved the way for the community to adjust to the changes in the political and social order.

Samuel P. Huntington argued that while governments are often categorized as democratic or undemocratic, they can also be divided into effective and ineffective governments.²⁶ Hong Kong, with its spectacular economic growth in the post-war era as a British colony, obviously had an effective but undemocratic system of government. The co-

²⁵Wai-kwok Wong, "The Provisional Legislature Directs the Legislative Council?", *Yazhou Zhoukan* (a Hong Kong Chinese weekly magazine) 11, no. 1 (December 30, 1996 to January 5, 1997): 30.

²⁶Huntington, I.

lonial government had won its legitimacy by results. The HKSAR government had hoped to do the same. But unfortunately the economic difficulties since the establishment of the HKSAR have led many people to regard the government as incompetent.

The expanding gap between people's expectations of leadership from the HKSAR government and their disappointment with its performance exacerbates their dissatisfaction. Meanwhile, the economic difficulties, the restructuring of the economy, and the widening gap between the rich and poor exerts further pressure on the government. There is considerable concern that rising unemployment and the widening gap between the rich and poor will become sources of social unrest. Hong Kong's unemployment rate rose to 6.1% in the June-August 1999 quarter, and many economists expect that it will only come down slowly.²⁷ According to a study by the United Nations and the World Bank, Hong Kong ranked 79th among 93 countries or regions in efforts to eliminate the disparities between the rich and poor. In 1996, the Gini coefficient of Hong Kong reached 0.518, which was higher than that of Malaysia, Thailand, the Philippines, and China. The economic difficulties in 1997-1998 probably have exacerbated the situation. The territory's adult illiteracy rate is 8%, which reflects that Hong Kong's uneducated and unskilled labour force remains substantial and will increasingly find it difficult to secure employment.²⁸

The situation is not yet an explosive one. Hong Kong people understand that it is im-

portant to maintain social stability so that the territory will continue to attract investors. But many people are unhappy and frustrated, and they easily blame the government for their problems. The latter, on the other hand, has to intervene more in the economy because of the recession and has to define long-term social service strategies which have long been neglected. It, therefore, badly needs strong support from the community, and its task has become all the more difficult because of the people's declining trust and respect for the government. All parties concerned realize that an effective HKSAR government is a prerequisite for Beijing to maintain its non-interference policy concerning Hong Kong.

Lessons from the Hong Kong Case Study

The Hong Kong case study is significant in that effective governance has been achieved in the absence of full democracy. The purpose of this article is not meant to dismiss democracy, but rather to illustrate that effective governance depends on a number of variables which are normally associated with democracy, but under a rather unique set of circumstances, they can exist in the absence of democracy.

Samuel P. Huntington's hypothesis on political participation in developing countries to a certain extent helps us to understand why the desire for political participation has remained low in Hong Kong in the post-war period. The refugee mentality under colonial rule is a kind of political alienation. In the lower socio-economic strata, this political alienation generated a sense of political impotence, resulting in little desire for political participation. The feeling of isolation among those who had moved to the big

²⁷*Ming Pao* (a Hong Kong Chinese newspaper), September 21, 1999.

²⁸*Ibid.*, October 17, 1998.

city from the rural areas in China and the failure to understand English also strengthened this sense of political impotence. Among those in the upper-middle and upper socio-economic strata, the limitations of political reform produced another type of political alienation, the feeling that political participation was meaningless. This minority was largely the beneficiary of the *status quo*, and naturally they had no strong commitment to work for constitutional reforms.

Situated at the periphery of China also brought uncertainty to the prospects of any thorough constitutional reforms; this fear of the unknown prompted the majority of the people to opt for the maintenance of the *status quo*. After all, rapid economic growth and stable colonial rule made Hong Kong people the fortunate ones in Asia. Moreover, behind the benevolence of the colonial administration, there was also a strong "stick" of suppression.

The post-war education system had a significant impact on the territory's political culture and political participation. Education produced the professionals and skilled workers who worked for the economic development of Hong Kong, which in turn reduced the desire for political participation. The open and competitive education system also offered an important channel for upward social mobility which much weakened class-consciousness. Those who had succeeded in the education system joined an English-speaking elite who was also proud of their acquaintance with the British culture. This elite was then gracefully incorporated by the Establishment. This process much reduced the contradiction between the colonial government and the local elite and enhanced the former's legitimacy.

The education system had successfully suppressed any nationalist sentiments too. Its pragmatic, utilitarian values and emphasis on self-reliance were important factors behind the territory's political culture depicted as "utilitarian familism". An elite with such values could easily be co-opted by the British administration through the process of "administrative absorption"; and before the end of the 1960s, politically ambitious members of this elite failed to co-operate with the lower socio-economic strata.

The nature of the colonial government denied the business community most channels of gaining political power. The political philosophy of the colonial regime also gave no such incentive to the business leaders. Hence, senior government officials were in general left undisturbed by vested interests and could maintain law and order in a fair and neutral manner. Since the 1960s, they could also take the initiative in improving labour legislation and providing social services.

Demands for political participation began to emerge in the 1970s. At the same time, the British administration vastly expanded its social service commitments, and its "administrative absorption" evolved to encompass the elites from all social strata. Its image was also improved by attempts to be a "government by consultation", while the China factor continued to block demands for thorough political reforms. Economic development consistently raised the people's living standards and lowered their demand for political participation, and the community was even proud of not being affected by the "British disease", the symptoms of which included too much social welfare, militant trade unionism, frequent labour disputes,

decline in economic competitiveness, etc. As no obvious contradictions existed, radical ideologies were unattractive to the community. In sum, the dominant values in the society and the education system prevented the emergence of a "participatory" political culture.²⁹

Despite the absence of constitutional democracy in the territory, there was ample liberty and the rule of law was observed. This was because the colonial government in Hong Kong ultimately had to be accountable to a democratic government willing to defend freedom and the rule of law. Many Third World countries have experienced an erosion of their democratic political systems after independence. Under such circumstances, they may be able to retain their stability and prosperity, but liberty and the rule of law are bound to be adversely affected. The colonial government also laid the foundation for an excellent civil service system which was able to attract talents from the community and won the respect of Hong Kong people. It deserves attention that the freedoms enjoyed in the territory included freedom of the media which provided an important means of checks and balances.

The Sino-British negotiations on the future of Hong Kong generated expectations of autonomy and democracy, but Beijing's position soon suppressed the community's demand for democracy. However, the process also created a confidence crisis and an upsurge in emigration, especially in the aftermath of the Tiananmen Incident; it also damaged any consensus on the political system for the future SAR.

Hong Kong people's confidence at this stage is mainly based on two assumptions: the first is that the trends of economic reform and opening to the outside world are irreversible in China, and the second is that the Chinese leadership is determined to maintain the stability and prosperity of the territory. The Hong Kong community understands that the maintenance of the "one country, two systems" arrangement also depends on the following considerations: (a) Hong Kong's contribution to China's modernization efforts; (b) the territory's demonstration effect on Taiwan; (c) if the existing conditions deteriorate in Hong Kong, the confidence of the international business community in China will be adversely affected; and, (d) change of China's policy toward Hong Kong will affect the confidence and morale of the reform-oriented cadres in China, too.

Apparently Hong Kong people adopt a utilitarian attitude toward democracy. They see democracy as a means to realize practical, concrete objectives. Few Hong Kong people really practise democracy as a way of life. Since Hong Kong people treat democracy as a means to an end, they are prudent in the calculation of the costs of political participation. While they perceive democracy as an important means to guarantee their freedom, their lifestyle, and their living standards which they treasure, they also consider one's own efforts to be more significant and more reliable in improving one's life.

People in Hong Kong probably understand that they cannot have genuine democracy until there is democracy in China. For democracy to take root in China, one has to wait for two to three decades for the prerequisites of democracy to emerge and de-

²⁹See Gabriel A. Almond and Sydney Verba, *The Civic Culture: Political Attitudes and Democracy in Five Nations* (Princeton, New Jersey: Princeton University Press, 1963).

velop. In the foreseeable future, maintenance of the rule of law and freedom of the media in the HKSAR are perhaps more important than the further development of representative government. Political development in the post-war era in Hong Kong has been a process of promoting citizens' demands and rights, or those of a segment of the community, through the pressure of public opinion, legal means, and pressure group activities within the existing political system. In

this process, there has been an implicit negotiation of the "winner takes all" model, and all parties concerned accept that the process is one of long-term negotiation, bargaining, cooperation, and resolution of conflict.³⁰ Such a process probably has an important demonstration effect on China at its stage of political development.

³⁰Tang Tsou, *Twentieth Century Chinese Politics* (in Chinese) (Hong Kong: Oxford University Press, 1994).

INDONESIA

The Challenge of Change

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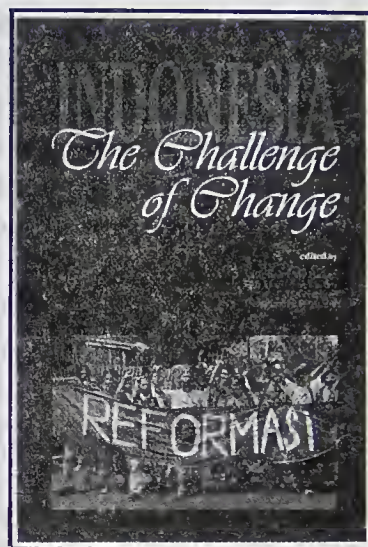
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THIS volume, which is the product of study conducted jointly by two research institutions, the Centre for Strategic and International Studies (CSIS) in Indonesia and the East-West Center in the United States, provides a collection of essentially Indonesian insights on institutional changes in Indonesia.

The study has identified a number of the underlying institutional problems that contributed directly to the gravity of the 1997-1998 crisis and to Soeharto's ultimate downfall. It is focused on how the different institutions, including the bureaucracy, the armed forces, the media, and private and public enterprise, have been responding to the process of change. The changes brought about by the growth, and the differing reactions to them across a society, are the major factors in determining the further evolution and future stability of the society. These questions are particularly salient in a period of major political change, and Indonesia has now entered such a period.

The book is organized into four sections. Section I covers issues on the economy, such as the growth and private enterprise (*Didik J. Rachbini*), as well as public enterprises under the New Order (*I Ketut Mardjana*). Section II deals with issues on government



and politics, covering the political institutions (*Ramlan Surbakti*), the bureaucracy (*T.A. Legowo*), the armed forces (*J. Kristiadi*), and the performance of political parties (*M. Djadijono*). Section III focuses on mixed institution, such as trade unions and labour unrest (*Sukardi Rinakit*), Education (*Onny S. Priyono*), and Mass Media (*Dedy N. Hidayat*). Section IV includes discussions on Nahdlatul Ulama (*Douglas E. Ramage*), the empowerment of civil society (*Muhammad A.S. Hikam*), as well as policy advisory institutions (*Dewi Fortuna Anwar*).

This volume may contribute to a better understanding of the fundamental issues behind the ongoing crisis; and, it may enrich the international scholarly dialogue on these subjects.

This volume is recommended particularly for those who are interested in the study of Indonesian politics.

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Poverty Alleviation in Indonesia Since the Economic Crisis: Beyond Immediate Relief

Marc Jacquand

Introduction

IN a recent paper on the social impact of the Asian crisis, Anne Booth wisely observed that scholars were still debating the impact on poverty of the Great Depression of the 30s, sixty years after the events. Efforts to examine the links between macroeconomic policies, crisis and the social consequences are indeed not an easy task and the situation in Indonesia since 1997 is no exception.

After having achieved impressive success in reducing its poverty figures over the last twenty years, the Republic of Indonesia was suddenly faced with a severe economic downturn that threatened to throw most Indonesians back into poverty. Two years into the crisis, the debate over the true social consequences of the recession is still alive, although on the wane. The following paper does not intend, nor could it pretend, to take part in the battle of statistics and quantitative technicalities that has been waged between various actors in the field. On the contrary, its purpose is to evaluate the situation of Indonesia through a comprehensive and critical study of the responses and the role of all the actors involved in the fight to alleviate poverty.

The analysis aims ultimately at determining how Indonesia's social policies might evolve from their current immediate relief status given the political and macroeconomic conditions.

Following a rapid overview of Indonesia's pre-crisis record on poverty alleviation, this paper will then attempt to sum up the evidence and the findings recently released on both the quantitative and qualitative impact of the crisis in order to highlight the various resulting policy options. Despite the controversy surrounding these figures, the undeniable certainty that many have suffered from the recession has led the authorities to start or revamp a number of programs in concert with the international agencies and the local agencies. Two years into the crisis, this study proposes a synthetic evaluation of the effectiveness of these programs, based on the own appraisal of the actors directly involved. Finally, the paper will attempt to outline what lies ahead in the fight against poverty. Ultimately, given the political and macroeconomic outlook, policy makers will have to choose among various options, based on a set of priorities, which this paper offers to draw as a conclusion.

Indonesia and Poverty Before the Crisis: An Overview

Indonesia's story until the 1997 crisis is one of remarkable economic success, one that has captured the attention of many experts and policy makers. It figures on prominent display in the literature and the textbooks made available to students in the field of development. From a steep recession in 1965 (8 percent decline in GDP), the country's economic development took off in the seventies, earning tremendous windfalls benefits from the oil shock. This bonanza development carried over throughout the eighties and into the nineties despite the oil counter-shocks. From 1985 through 1995, the GDP rose at an average rate of 7.1% (World Bank, 1998). Economic growth was accompanied by a spectacular reduction in the percentage of the population living under the poverty line. From an estimated level of 55% in 1978 (Hamsworth 1979, 4), the levels declined to the official level of 11.3% in 1996. The following table summarizes the gradual decline:

YEAR	URBAN		RURAL		TOTAL	
	Million	%	Million	%	Million	%
1970	-	-	-	-	60	-
1976	10.0	38.0	44.2	40.4	54.2	40
1984	9.3	23.1	25.7	21.2	35.0	22
1990	9.4	16.7	17.8	14.3	27.2	15
1996	6.9	10.0	15.7	12.0	22.6	11.2

Source: Central Burzau of Statistics, 1997.

As can be seen in the next section, the accuracy of these official figures has often been challenged on methodological grounds by nongovernmental organizations. However, no one disputes the veracity of the overall trend in poverty reduction since 1970.

Obviously, the leading explanation for this accomplishment resides in the trickle down effect of economic growth. Yet, as Robert Aten, chief economist at USAID, points out, certain proactive government policies, such as increasing education for women, were also instrumental in the fight against poverty. The Government launched a series of social services as part of its Long-Term Development plan (PJP I), which included the expansion of primary schools and health centers (UNSFIR 1999, 85). Despite certain flaws, the Rice Plan, which included a price stabilization scheme through government intervention, led to improved nutritional conditions for the population. In fact, up until the crisis, the greatest poverty alleviation tool remained commodity price manipulation, which the government has used as a form of general subsidy.

On the eve of the crisis therefore, the outlook was bright. There remained pockets of acute poverty, particularly in the remote regions of Irian Jaya and Sulawesi yet, the prevalent feeling was that with the 11.3 per cent figure, Indonesia had reached the threshold ol experts called "hardcore" or "chronic" poverty. The emphasis now needed to shift from a national scheme to a more targeted, localized approach. In the late 80s and early 90s, the government designed new policies, based on the principle of local empowerment. Through this new "socioeconomic" approach, officially referred to as "Gerdu Teskin" (stands for *Gerakan Terpadu Pengentasan Kemiskinan*), various programs such as the income generating *padat karya* and the community funds for backward villages were activated in the hope of tackling the remaining pockets of chronic poverty. In this context, the international community could offer little

help. In fact, a number of international development agencies such as USAID and UNDP were just about ready to end their operations in Indonesia, lock the door and go home, considering that the country was now on cruise control after a successful lift-off. Although no national safety net program existed, aside from the *Jamsostek* system required by law in the formal sector, and while many Indonesians still lived in a state of precariousness, things were thought to be falling into place smoothly, in due course.

When the course took a turn for the worse in the summer of 1997, it was immediately feared that, with the economy grinding to a virtual standstill combined with a severe El Nino-induced drought, many Indonesians would be thrown back into poverty. The question was then raised: to what extent would the crisis wipe out the success that had been painstakingly achieved since the seventies?

As mentioned in the introduction, what has really happened is still not clear. Yet, after months of debate experts from various government and non-government agencies are now, so it seems at the time of this paper, moving towards somewhat of a consensus. In the following section, we will briefly summarize the findings and analyze the latest data that has been released, and shed some light on the controversy, in order to highlight the divergence in terms of policy options that resulted from it.

Poverty Since the Crisis: From Controversy to Consensus?

The social impact of the crisis in Indonesia has been the subject of a rabid debate among poverty methodologists and statis-

ticians. The controversy erupted in the summer of 1998, when three separate reports were published almost simultaneously, each giving very different estimates of the social consequences of the recession, which led to a series of debates, updates, research papers, revisions and counter-revisions whose drama has been well documented. Let's briefly summarize the main facts: The World Bank first reported in July of 1998 that the economic crisis would push the incidence of poverty up to 14.1% of the population in 1999, up in fact, from 10.1% right before the crisis (World Bank 1998). At the same time, the Central Bureau of Statistics published an alarming estimate of 39.9%, translating into a poverty population of 79 million. The International Labour Organization (ILO) added to the drama by predicting that poverty figures would actually rise to 48% (ILO 1998). Obviously, some fine-tuning was needed on someone's part. In 1999, as the clouds of controversy start to dissipate, various theories have been brought forth to explain these differences.

One must first look back to the summer of 1998 and understand the context in which these reports were published. There was at the time very little hard data on which to work aside from local surveys. Therefore, most estimates were based on assumptions and impressions. Not surprisingly, in the wake of the riots and as the price of rice skyrocketed, fears of mass starvation, fears of widespread unemployment and devastating poverty seemed legitimate at the time. Immediate evaluations and forecast based on this pervasive sense of chaos were inevitably extreme. As BPS Chairman Suwito explained during a press conference on 9 July 1999, "the mid-98 predictions were made among gloomy macroeco-

conomic and political conditions" (*Jakarta Post*, 12 July 1999).

At the same time, two conspiracy theories arose. The first one, aimed at the World Bank's low estimate, insisted on the organization's interests in understating poverty in order to reduce the disbursement requirements. The second one focused on the government's interests in overstating the poverty levels, in order either to bloat the financial aid package much needed in times of elections or to display new independence. Both theories have persisted ever since but neither deserves any more acknowledgment.

In fact, the most credible explanation resides in the obscure realm of poverty data methodology. As more people began to pore over the initial estimates and new data was made available, it became clear that serious flaws in methodology had skewed the analysis. The issues can be summarized as follows:

- **Nominal versus real income:** The most dire estimates were based on the erroneous assumptions that nominal incomes would either decrease or remain stagnant while inflation rose to 80%, which would have translated into a dramatic fall of real incomes, when in fact nominal household incomes and expenditures experienced a slight increase. In the case of the initial BPS report, it was BAPPENAS, the National Development Planning Board, who signaled the error, which has been rectified since.
- **Sample size:** In early 1999, SMERU, the monitoring agency set up by the World Bank, released a revisionist report revealing a "more complex and heterogeneous" picture than the most pessimistic

estimates had painted, arguing that "the social impacts of Indonesia's crisis, while serious, have fortunately been less dramatic than early reports" (SMERU 1999, 1). This new report came under fierce criticism for it was based on small-scale surveys whose reliability could not be trusted (UNSFIR 1999, 4). As it turns out, the standard error of these surveys proved reliable enough and their results were later confirmed by newly released data.

- **Consistency in the poverty line:** As BPS gradually revised its estimates downward, it also became clear that the methodology used for the 98 figures was inconsistent with the one used for estimates previous to the crisis. These inconsistencies, for example in the choice of non-food bundles, were outlined by many prominent experts in the field, including Lant Pritchett (World Bank), Professor Ikshan (LEPM), Sudarno Sumarto (SMERU) and Franck Wiebe (Harvard Institute). For example, they argued that the methodology used for the newly revised figure of 24.23% released by BPS would show a 19% poverty rate in 1996, way up from the official figure of 11.3% (Wiebe, July 1999). On 21 July, BPS published a report outlining the different methodologies available to evaluate the crisis-induced poverty, thereby discreetly acknowledging these inconsistencies. The conclusion of the report, if one reads between the lines, is that with one methodology, Indonesia went from a 19.23 per cent poverty level in 1996 to 24.23% in 1998; with the other, the poverty level went from 11.3% in 1996 to 16.74% in 1998 (Sutanto, 1999).

Two years into the crisis, the debate over its social impact has now, it seems, moved beyond controversy to an inkling of consensus. Yet, far from simplifying the task for policy makers, the consensus figures increase the complexity of the situation. Indeed, under the most catastrophic scenario, the policy answer becomes self-evident. Faced with mass poverty and widespread unemployment, the only choice is to implement a general subsidy, and targeting is rendered useless. In the case of a 40 per cent or 50 per cent poverty level, a general food subsidy for example would have an equivalent success rate of 40% to 50% which is remarkable for any targeted program. On the other hand, if the actual number hovers around 17%, a general subsidy would significantly waste the limited resources, and would in fact have detrimental and counter-productive effects on poverty alleviation. In this case, successful targeting becomes critical. It is therefore important, two years after the start of the crisis, and once the immediate panic has receded, to evaluate the true impact of the crisis, in order to make the best use of the limited resources available in these times of fiscal austerity and economic stagnation.

As described previously, if one applies the same methodology consistently, the crisis-induced impact of poverty measured from 1996 to now is situated between a 5 and a 6 percentage point increase (or roughly 50%). However, as Lant Pritchett pointed out, if measured from the lowest pre-crisis levels, which the World Bank reported to be 10.1%, to the worst levels of the crisis, in September 1998 after prices skyrocketed, one can assume that poverty almost doubled for a short period of time.

Many believe that the poverty level now stands between 16 and 18% of the population, if one bases the analysis on the 1996 11.3 per cent figure.

On the employment front, initial reports of mass unemployment received considerable publicity but quickly waned for lack of empirical evidence. As John Maxwell (SMERU) pointed out, in the absence of a safety net program, one cannot stay unemployed in Indonesia. What did happen is a fall in real wages, the expansion of the informal sector and the reliance on coping mechanisms. One of these mechanisms has been, according to Ahmad Djauhar (*Bisnis Indonesia*), the return of many urban workers to the rural areas (*Les Echos*, 7 June 1999: 70). In fact, newly released data suggests that the incidence on employment during the economic crisis in Indonesia has marked a shift from well documented relationship between poverty and urban bias. Employment figures by industry indeed show an increase in agriculture, forestry, fishing & fishery that appears significant enough to partially offset the losses in the manufacturing, construction and trade sectors (World Bank, 1999b: Table 31). Combined with the unaccounted rise in the informal sector, it is no surprise to find only minimal changes in the national unemployment rate.

The crisis has also had serious consequences on the education sector but, as we shall see in the following sector, due to swift intervention, the enrollment ratios have not declined as dramatically as feared originally. As the World Bank reports, "all of the data sources are consistent that the fall in enrollments is much larger at the secondary level (2.3%) than at the primary level (1.5%)"

(SMERU 1999, 25). In fact, the fall at the primary level is part of a trend that started before the crisis.

Impacts on health conditions are more difficult to gauge yet, as drug prices have doubled or tripled since the start of the crisis, it is feared that many poor are unable to seek medical assistance or treatment (World Bank 1999a, 14).

As SMERU reported in February, the impact is "less dramatic than early predictions suggested" (SMERU 1999: 32). Yet, no one denies that the situation is extremely serious and furthermore, extremely complex. While the overall picture clear sup, it is yet very difficult to assess the geographic distribution of the crisis-induced poverty across the 27 provinces. Initial reports show important regional disparities with urban Java being the hardest hit while other agriculture-oriented areas might have benefited from the devaluation of the rupiah to increase per-capita income (Les Echos, 71). Recent studies conclude otherwise, arguing that "the notion that the crisis was a Java problem is contradicted by data" (Papanek 1999). Obviously, as more data becomes available policy officials will get a better sense of what to do and how to do it. Unfortunately, poverty does not hide aloof, waiting for methodologists to fine-tune their analyses before striking. Certain simple yet vital policy issues had and remain to be tackled despite the uncertainty: who gets help? and where? And how should resources be allocated between crisis-induced transient poverty and chronic poverty?

The next section offers a critical look at how these questions have been addressed so far.

The Response to the Crisis: Evaluation of the Crash Programs

The devaluation of the Thai baht in July of 1997 is unanimously considered to be the official starting point of the Asian economic crisis. However, the adverse effects began to bite in 1998 only, as the economic recession coincided with a severe drought and the most serious political crisis of the country's history. In fact, as mentioned previously, the World Bank estimates that, by the end of 1997, the incidence of poverty actually declined from a 1996 level of 11.3% to 10.1%, as nominal income rose faster than inflation (7% and 5%).

Indonesia hit rock bottom during the summer of 1998. Many people interviewed for this report remember vividly the impression of virtual chaos that gripped Jakarta as the riots and the soaring inflation seemed to bring the country to a standstill. This quick reminder of the situation at the time is needed to understand the context under which the first programs were implemented. As soon as the new government took office, the alarmist reports about widespread poverty were published, adding to the sense of urgency in reacting to the crisis. As a result, a plethora of programs was launched in each ministry, and old ones were either revamped or accelerated.

The response to the social impacts of the crisis can be categorized into three key programs: (i) food security; (ii) employment creation; and (iii) social protection. This three-pronged approach attempted in fact to address the three options of poverty policy outlined by most scholars in the field -- i.e. to increase consumption with a given income, to reduce the number of poor by providing income and to improve the so-

cial and environmental circumstances of the poor. The main features of this ambitious safety net program, referred to as JPS, are outlined in the following box, as they were presented to the World Bank board of directors on a proposed social safety net adjustment loan (SSNAL).

This list does not pretend to be exhaustive. One could add to it the emergency operation launched in April 1998 by the World Food Program together with the United Nations Food and Agriculture Organization (UNSFIR 1999, 59). Also in 1998, the government started the Kecamatan De-

velopment Project (PPK) in concert with the World Bank. Designed before the crisis, the PPK is a 3 year \$270 million project aimed at spurring economic activity at the local level, with each *Kecamatan* receiving between 500 and 750 million rupiah. A year after the start of the Indonesian crisis, how have these programs fared?

By pooling the views of the actors directly involved in the monitoring process, one notes that the JPS has produced mixed results, with some programs achieving remarkable success while others have failed almost completely. The two most success-

KEY SAFETY NET PROGRAMS

Food Security

- OPK (*Operasi Pasar Khusus*): a program to distribute a certain amount of rice per month to targeted households at subsidized prices. The program was implemented in July of 1998. Originally, poor families were allowed to buy rice up to 10kg/family at Rp 1,000/kg. Upon the recommendations of SMERU in December, the subsidy was raised to 20kg/family.

Employment Creation

Community Funds

- PDM-DKE: implemented after the crisis, this program provides funding directly to local governments for use in open menu, labour intensive and other employment creation activities.

Padat Karya

- *Cipta karya*: social safety net income generation schemes through extended public works. Originally, each ministry had its own *padat karya* program. Following unanimous criticism from independent monitoring agencies, these programs were recently consolidated under the Ministry of Public Works.

Social Services

Education

- Student Scholarship and Block Grant: a program which provides scholarship to targeted students for junior secondary school and block grants directly to schools.

Health

- Pharmaceuticals: a program to subsidize key generic drugs.
- Basic Health Care: a set of programs to strengthen the health care in local clinics (*PUSKEMAS*).

ful programs have been the Back to School program and the OPK rice subsidy. The scholarship program has been hailed as "the most impressive of the safety net programs" because of its efficient targeting and the tangible assistance that it provides (World Bank, July 1999, p. 2.6). Overall though, there is a unanimously acknowledged lack of funding. In terms of budget allocation, Indonesia's commitment to education approximately 8% of its GDP, compares unfavourably with its neighbours, with a figure of 18% in Malaysia for example (*Jakarta Post*, 13 August 1999). At the end of 1998, SMERU published the results of a field appraisal mission it had undertaken in five provinces to observe the implementation of the OPK program. The results were generally positive. However, SMERU offered a series of recommendations, including extending public information, improving locally-based targeting and the previously mentioned increase in the rice allocation (SMERU 1998, 8).

On the other hand, the income-generating programs have received harsh criticism from most observers. At the outset of the crisis, various ministries were asked to revive and implement a *padat karya* scheme in their field of competence. The unfortunate consequence was a plethora of incoherent, sometimes overlapping yet always-confusing programs whose targeting and implementation proved very costly. In many cases, public works were devised without any assessment of the labour supply available in the area. After a major overhaul spurred by various monitoring agencies, it was recently decided to consolidate all the *padat karya* schemes into one program within the Public Works Ministry, who possesses the best imple-

mentation record according to some independent agencies.

Similarly, the community funds program, known as PDM-PKE, has been widely criticized for being badly devised, poorly implemented and weakly monitored. Based on the principle of local empowerment, the program has mainly suffered from widespread misuse of funds. Again, the context cannot be ignored. Many believe that the funds were sometimes used to buy off votes for one party or another. While these accusations are serious, they should not have been unexpected during a year of political turmoil and electoral campaigning. The government was forced to undertake a complete overhaul of the program. So into the new fiscal year, pending reforms, funds have yet to be disbursed for the PDM-PKE.

Other efforts such as the health programs have shown mixed results, depending on the geographic situation. According to field observations by the Urban Poor Consortium, many urban poor have been unable to receive medical assistance because they were unregistered as residents of the city they are in.

Overall, all these programs have suffered from the same ills, be it at varying degrees and all could benefit from the same improvements: better targeting, expanded public information, faster delivery mechanisms and extended monitoring of fund allocation, and increased coordination between the ministries. Yet one should insist again on the context under which these programs, crash programs for the most part, were launched. In addition to the sense of urgency, the efforts were sometimes plagued by various conflicts of interests between the govern-

ment, the international organizations and the local NGOs. The JPS was sometimes used as a political showcase intended, on one the hand, to gain legitimacy on the international scene, and, on the other hand, to channel opposition to an interim government. In the midst of these domestic quarrels, Lant Pritchett notes that only two options remained. The first one would have post-poned international aid to the JPS until the end of the political transition, in order to ward off accusations of political collusion. The costs with this option were evident, for poverty does not wait for political disputes to recede before it begins to bite. The other one was therefore to stop the bleeding immediately by disbursing much needed financial help, at the risk of abetting certain devious political goals. Consequently, JPS was plagued by inevitable conflicts between the government and the non-governmental organizations. The necessity to increase the role of civil society in any poverty alleviation program has been well documented. Yet, in a time of highly charged political uncertainty, one could only reiterate the need to strengthen the ties between high-level government officials and local civil agents. The controversies and criticism surrounding the monitoring board, established by presidential decree, highlighted the various conflicts of interests that have plagued the implementation and monitoring process of the JPS. As the democratic transition nears its final obstacle in November 1999, one can only hope that the poverty alleviation efforts will find some respite from political manipulation.

After outlining these circumstances, from the sense to urgency to the ensuing political maneuvering, the technical prob-

lems found in each program should come at no surprise. In fact, based on various independent opinions, one can offer a positive global assessment of the response despite all the difficulties encountered. As Sven Sandstrom, managing director of the World Bank, recently said: "the JPS is not perfect, but it is necessary" (*Observer*, 29 July 1999). This positive appraisal, pending various improvements previously mentioned, has led the World Bank to propose a \$600 million Social Safety Net Adjustment Loan to support the ongoing effort to alleviate the impact of the crisis. Disbursement of the first of two tranches of the performance-based loan is expected in the coming weeks.

As we enter the second year of the JPS, and despite the optimistic impression that this section might have created, two important lessons can be drawn from the past year:

- The PDM-PKE should never have been implemented by the government nor supported by the financial donors. Unlike the Back to School program and the rice distribution which provide direct and tangible assistance that can hardly be diverted for other purposes, the community funds scheme is a blatant invitation to foul play, especially with elections in the offing. The political and economic costs have clearly outweighed the benefits envisioned for this program. Similarly, the *padat karya* programs should have been kept in check. In times of political uncertainty and institutional weakness, crash help should focus on tangible, non-corruptible resources.
- Improve overall coherence of JPS: in addition to administrative streamlining, a closer look should be taken at the existence of conflicting programs. For example,

certain income-generating projects, such as the ones funded by the Community Recovery Program, whose purpose is to help urban children earn some income, are sometimes detrimental to the Stay in School policy.

The following section offers a tentative analysis of what priorities should be drawn from these lessons, given various assumptions on the political and macroeconomic outlook.

Beyond Immediate Relief: Defining Priorities

Many challenges still loom large on Indonesia's path to recovery. In the fight against poverty, the main task is now to move beyond a situation of immediate relief, streamline the policies and define an effective long-term approach. In times of recession, officials often establish a distinction between crisis-induced poverty, referred to as *transient poverty*, and *chronic poverty*. As mentioned previously, in the case of Indonesia, the social impact of the recession is estimated at 5%, which translates into an additional 15 million people falling beneath the poverty line, while the official pre-crisis figures stands at 22 million. Once immediate relief has been handled, this distinction becomes necessary if one tries to devise the most effective policies, for each facet of poverty requires a separate approach. The ensuing analysis does not intend to look at what should be done ideally but what can be done under the present political and economic circumstances. Indonesia clearly lacks the financial and institutional resources to implement proactive policies for everyone. From the financial mess to poverty, the path is strewn with obstacles, which cannot be overcome if certain prior-

ities are not set. This paper suggest that the authorities should target the very poor first, while fighting transient poverty with effective macroeconomic policies. *This approach is based, of course, under the underlying assumption that immediate relief from the crisis, in terms of food availability and proper health conditions, has been guaranteed for everyone.*

Erasing Transient Poverty

As mentioned previously, the dramatic decrease in poverty from 1970 to 1996 was a direct consequence of economic growth. In 1998 though, a large number of people were thrown back into poverty as a result of hyperinflation and falling real wages. They usually find themselves on the higher end of the poverty scale and are often referred to as transient poor as it is anticipated that a return to growth will lift them out above the poverty line. Undoubtedly, the return to stable macroeconomic conditions remains the most efficient tool to solve poverty. Yet, the outlook five months into the new fiscal year offers mixed signals.

On one hand, the battle against inflation seems to have been won. On 3 August 1999, BPS reported that an inflation rate of -1.05% for the month of July, the fifth consecutive month of deflation. On a year on year basis, inflation now stood at 13.49%, compared to 24.5% in June (*Jakarta Post*, 3 August 1999). Especially important is the recent drop, 3.46% in July, in commodity prices. Should it last, this trend will lead to lower poverty figures as real incomes slowly recover.

Some experts offer a pessimist forecast for growth. As Robert Aten points out, Indonesia currently suffers from a lack of dom-

estic pull and therefore needs to export its way out of the crisis. However, after a few months of feeble growth, the region's economies are showing signs of weaknesses. The anticipated cooling off in the United States and persistent sluggish performances in Europe will not help. Moreover, the issue of the optimal exchange rate remains unsolved. While some believe that the rupiah might already be overvalued at 6500 to the dollar, a weaker export-boosting rate might dampen investor's confidence and delay the much-needed inflows of capital.

Furthermore, once growth, albeit modest, is achieved, many linkages need to kick in before it impacts poverty figures. Only if growth is less distorted than what it was before the crisis can its benefits be distributed more broadly, through an expansion of the formal sector and a tightening of the labour market. While this paper does not pretend to explain the causes by settling the score between the domestic problems and the flaws of the global financial architecture, it is certain that over-investment in property artificially inflated the GDP growth rate without any redistributive effects on the population. In fact, slower rates based on tangible and tradable output are more likely to have trickle-down effects than the speculative growth experienced in the past, such as in the real estate industry. Under the current circumstances of sluggish world demand, Indonesia is unlikely to achieve high growth rates. The most optimistic predictions tentatively point to 3% in 2001. However, if focused on the real economy and based on the sound macroeconomic principle of low inflation, lower growth rates should be a cost-effective way to lift the transient poor as well as the near poor out of precariousness.

Targeting the Very Poor

Political calculations often lead policy-makers and government officials to devote excessive attention to the poverty line, when in fact the most troubling picture of poverty resides in the poverty gap. While fighting the poverty gap is a hard and complex task, helping the "easy poor", those just below the poverty line is relatively simple. In their case, a little help, through income transfers, can have the politically convenient effect of a quick reduction in the head count ratio. Unfortunately, this calculation often leads to the wrong set of priorities. As seen above, under tremendous budget constraints, policies should be reversed. Let macroeconomic stability lift the easy poor out of poverty and retain the bulk of the resources to devise proactive measures to eradicate chronic poverty.

Yet, helping the very poor is even more complex and often requires hard-hearted decisions. Based on last year's experience through the JPS, one could make the following suggestions:

- Increase the self-targeting schemes: the issue of who gets what and where is probably the most difficult one to solve and therefore requires priority attention in terms of resources in the short term because its resolution offers the greatest impact in terms of cost-efficiency in the long run.
- Avoid program overload, especially when the bad programs can have adverse consequences on the entire effort. In the case of Indonesia, the JPS's overarching goal to address the three dimensions of poverty policy can be counterproductive. Priorities need to be defined in

order to achieve greater success in the long term as follows:

- (1) Officials should first and foremost focus on food security and basic health services availability. For this, the OPK and the PUSKESMAS systems have already shown that they can be effective.
- (2) Once basic survival means are assured, reinsertion into the educational sphere through training grants and scholarships should be next on the agenda.
- (3) Limit the public works schemes to localized well-defined projects. While public work programs have the convenient advantage of artificially raising employment figures, they are seldom the answer for a long-term approach to the problem. Gustav Papanek from the Boston Institute for Developing Economies recently argued in favour of "expanding labour intensive works programs at a low wage" (Papanek 1999). Yet, under a cost-benefit analysis, overarching national programs are often a source of financial waste for very limited results. A more solid and enduring approach to job creation and income transfers should start with solving corporate Indonesia's problems to increase labour demand. As Gustav Papanek and Budiono Sri Handoko pointed out, "more rapid creation of jobs for unskilled workers is the key to long term poverty alleviation" (Papanek 1999). However, under the present circumstances, the government does not have the appropriate financial and institutional

resources to carry out ambitious labour intensive public works programs.

Concluding Remarks

The previous policy prescriptions require that two conditions be met: The first one is obviously the return to economic growth. While the recent stabilization in commodity prices has allowed real wages to recover some lost ground, further improvements are dependent on real growth. As most experts agree, this will take some time. This is why it is necessary to guarantee basic survival needs while the macro-economic situation improves.

The second one involves the current democratic transition. Most of the recommendations stated in the previous section emphasize the need to focus on the very poor, whose political clout is nonexistent. Prioritizing the very poor requires a strong commitment to disregard political calculations and vested interests in favour of the truly needy. In the case of Indonesia, this hinges upon the success of the current democratic transition and the establishment of a strong legitimate government.

Furthermore, these prescriptions and the various sets of conditions are all mutually reinforcing. A return to economic growth and its effect on transient poverty will facilitate the government's ability to direct its limited resources to fight chronic poverty. Similarly, a successful democratic transition will provide the necessary incentive for foreign investors to support Indonesia's economic recovery.

Nobel Prize laureate Amartya Sen once remarked that there has never been a famine in a country where there is free press, thereby pinpointing the quintessential political

nature of poverty. Indonesia is again no exception. While the responses to the crisis deserve an overall positive assessment despite certain flaws, the ultimate purpose of this paper is to show that what has worked in terms of immediate relief over the past year will not be sustainable in the long term. As mentioned previously, more statistical analysis is needed. Monitoring schemes call for improvement. Cost-benefit studies require fine-tuning. And priorities have to be set, for not every goal can be achieved at once. Nevertheless, beyond the research, the studies and calculations, the essence of the fight against poverty ineluctably belongs in the political sphere. One can only hope that the efforts of this past year can come to complete fruition under a legitimate and committed political setting.

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